



# Instructions for Forms 1120 and 1120-A

Section references are to the Internal Revenue Code unless otherwise noted.

Contents	Page
Changes To Note . . . . .	1
Photographs of Missing Children . . . . .	1
Unresolved Tax Issues . . . . .	1
How To Make a Contribution To Reduce the Public Debt . . . . .	1
How To Get Forms and Publications . . . . .	1-2
<b>General Instructions</b> . . . . .	2
Purpose of Form . . . . .	2
Who Must File . . . . .	2
When To File . . . . .	2
Who Must Sign . . . . .	3
Paid Preparer Authorization . . . . .	3
Where To File . . . . .	3
Other Forms, Returns, and Statements That May Be Required . . . . .	3-5
Amended Return . . . . .	5
Statements . . . . .	5
Assembling the Return . . . . .	5
Accounting Methods . . . . .	5-6
Accounting Periods . . . . .	6
Rounding Off to Whole Dollars . . . . .	6
Recordkeeping . . . . .	6
Depository Method of Tax Payment . . . . .	6
Estimated Tax Payments . . . . .	6
Interest and Penalties . . . . .	7
<b>Specific Instructions</b> . . . . .	7
Period Covered . . . . .	7
Name . . . . .	7
Address . . . . .	7
Consolidated Return, Personal Holding Company, and Personal Service Corporation . . . . .	7
Employer Identification Number (EIN) . . . . .	7
Total Assets . . . . .	8
Initial Return, Final Return, Name Change, or Address Change . . . . .	8
Income . . . . .	8-9
Deductions . . . . .	9-13
Schedule A and Cost of Goods Sold Worksheet . . . . .	14-15
Schedule C and Worksheet for Schedule C . . . . .	15-16
Schedule J and Worksheet for Members of a Controlled Group . . . . .	16-19
Schedule K . . . . .	19-20
Schedule L . . . . .	20
Schedule M-1 . . . . .	20
Codes for Principal Business Activity . . . . .	21-23
Index . . . . .	24

## Changes To Note

- For tax years ending on or after December 31, 2001, certain corporations with average annual gross receipts of more than \$1 million but less than or equal to \$10 million may be able to adopt or change to the cash method of accounting for eligible trades or businesses. This rule does not apply to corporations prohibited from using the cash method under section 448. For more details, including change in accounting method requirements, see Notice 2001-76, 2001-52 I.R.B. 614.
- The corporation may need to mail its return to a different service center this year because the IRS has changed the filing location for several areas. If an envelope was received with the tax package, please use it. Otherwise, see **Where To File** on page 3.
- A corporation may request that the IRS deposit its income tax refund directly into its checking or savings account at any U.S. bank or other financial institution that accepts direct deposits. For details, see the instructions for line 36 on page 14, and new **Form 8050**, Direct Deposit of Corporate Tax Refund.
- If the corporation wants to allow the IRS to discuss its 2001 tax return with the paid preparer who signed it, check the "Yes" box in the area where the officer of the corporation signed the return. See page 3 for details.

## Photographs of Missing Children

The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in instructions on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST** (1-800-843-5678) if you recognize a child.

## Unresolved Tax Issues

If the corporation has attempted to deal with an IRS problem unsuccessfully, it should contact the Taxpayer Advocate. The Taxpayer Advocate independently represents the corporation's interests and concerns within the IRS by protecting its rights and resolving problems that have not been fixed through normal channels.

While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure

that the corporation's case is given a complete and impartial review.

The corporation's assigned personal advocate will listen to its point of view and will work with the corporation to address its concerns. The corporation can expect the advocate to provide:

- A "fresh look" at a new or on-going problem.
- Timely acknowledgment.
- The name and phone number of the individual assigned to its case.
- Updates on progress.
- Timeframes for action.
- Speedy resolution.
- Courteous service.

When contacting the Taxpayer Advocate, the corporation should provide the following information:

- The corporation's name, address, and employer identification number (EIN).
- The name and telephone number of an authorized contact person and the hours he or she can be reached.
- The type of tax return and year(s) involved.
- A detailed description of the problem.
- Previous attempts to solve the problem and the office that had been contacted.
- A description of the hardship the corporation is facing (if applicable).

The corporation may contact a Taxpayer Advocate by calling **1-877-777-4778** (toll free). Persons who have access to TTY/TDD equipment may call 1-800-829-4059 and ask for Taxpayer Advocate assistance. If the corporation prefers, it may call, write, or fax the Taxpayer Advocate office in its area. See **Pub. 1546**, The Taxpayer Advocate Service of the IRS, for a list of addresses and fax numbers.

## How To Make a Contribution To Reduce the Public Debt

To help reduce the public debt, make a check payable to the: "Bureau of the Public Debt." Send it to Bureau of the Public Debt, Department G, P.O. Box 2188, Parkersburg, WV 26106-2188. Or, enclose a check with the income tax return. Contributions to reduce the public debt are deductible subject to the rules and limitations for charitable contributions.

## How To Get Forms and Publications

**Personal computer.** You can access the IRS web site 24 hours a day, 7 days a week at **www.irs.gov** to:

- Download forms, instructions, and publications.
- See answers to frequently asked tax questions.
- Search publications on-line by topic or keyword.
- Send us comments or request help by e-mail.
- Sign up to receive local and national tax news by e-mail.

You can also reach us using file transfer protocol at [ftp.irs.gov](ftp://ftp.irs.gov).

**CD-ROM.** Order **Pub. 1796**, Federal Tax Products on CD-ROM, and get:

- Current year forms, instructions, and publications.
- Prior year forms, instructions, and publications.
- Frequently requested tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- The Internal Revenue Bulletin.

Buy the CD-ROM on the Internet at [www.irs.gov/cdorders](http://www.irs.gov/cdorders) from the National Technical Information Service (NTIS) for \$21 (no handling fee), or call **1-877-CDFORMS** (1-877-233-6767) toll free to buy the CD-ROM for \$21 (plus a \$5 handling fee).

**By phone and in person.** You can order forms and publications 24 hours a day, 7 days a week, by calling **1-800-TAX-FORM** (1-800-829-3676). You can also get most forms and publications at your local IRS office.

## General Instructions

### Purpose of Form

Use **Form 1120**, U.S. Corporation Income Tax Return, or **Form 1120-A**, U.S. Corporation Short-Form Income Tax Return, to report the income, gains, losses, deductions, credits, and to figure the income tax liability of a corporation. Also see **Pub. 542**, Corporations, for more information.

### Who Must File

Unless exempt under section 501, all domestic corporations (including corporations in bankruptcy) must file whether or not they have taxable income. Domestic corporations must file Form 1120 or, if they qualify, Form 1120-A, unless they are required to file a special return (see **Special Returns for Certain Organizations** below).

**Limited liability companies.** If an entity was formed as a limited liability company under state law and is treated as a partnership for Federal income tax purposes, it should not file Form 1120 or 1120-A. Instead, file **Form 1065**, U.S. Return of Partnership Income. For the definition of a limited liability company, see the Instructions for Form 1065.

**Corporations engaged in farming.** Any corporation that engages in farming should use Form 1120 or, if they qualify, Form 1120-A to report the income (loss) from such activities. Enter the income and deductions of the corporation in accordance with the instructions for lines 1 through 10 and 12 through 29.

### Who May File Form 1120-A

Form 1120-A may be filed by a corporation if it met **all** of the following requirements during the tax year:

- Its gross receipts (line 1a on page 1) are under \$500,000.
- Its total income (line 11 on page 1) is under \$500,000.
- Its total assets (Form 1120, Schedule L, line 15) are under \$500,000.
- Its only dividend income is from domestic corporations and those dividends **(a)** qualify for the 70% dividends-received deduction and **(b)** are not from debt-financed securities.
- It does not have any of the “write-in” additions to tax listed on pages 17 and 19 in the Instructions for Form 1120, Schedule J, line 3 or line 11.
- It has no nonrefundable tax credits (other than the general business credit or the credit for prior year minimum tax).
- It is not: **(a)** a member of a controlled group, **(b)** a personal holding company, **(c)** filing a consolidated return, **(d)** filing its final return, **(e)** dissolving or liquidating, **(f)** electing to forego the carryback period of an NOL, or **(g)** required to file one of the returns listed under **Special Returns for Certain Organizations** below.
- It does not have: **(a)** any ownership in a foreign corporation or foreign partnership, **(b)** foreign shareholders that directly or indirectly own 25% or more of its stock, or **(c)** any ownership in, or transactions with, a foreign trust.

### Special Returns for Certain Organizations

Instead of filing Form 1120 or Form 1120-A, certain organizations, as shown below, have to file special returns.

If the organization is a	File Form
Farmers' cooperative (sec. 1381)	<b>990-C</b>
Exempt organization with unrelated trade or business income	<b>990-T</b>
Religious or apostolic organization exempt under section 501(d)	<b>1065</b>
Entity formed as a limited liability company under state law and treated as a partnership for Federal income tax purposes	<b>1065</b>
Entity that elects to be treated as a real estate mortgage investment conduit (REMIC) under sec. 860D	<b>1066</b>
Interest charge domestic international sales corporation (section 992)	<b>1120-IC-DISC</b>
Foreign corporation (other than life and property and casualty insurance company filing Form 1120-L or Form 1120-PC)	<b>1120-F</b>
Foreign sales corporation (sec. 922)	<b>1120-FSC</b>

Condominium management association or residential real estate management association that elects to be treated as a homeowners association under section 528	<b>1120-H</b>
Life insurance company (sec. 801)	<b>1120-L</b>
Fund set up to pay for nuclear decommissioning costs (sec. 468A)	<b>1120-ND</b>
Property and casualty insurance company (section 831)	<b>1120-PC</b>
Political organization (section 527)	<b>1120-POL</b>
Real estate investment trust (section 856)	<b>1120-REIT</b>
Regulated investment company (section 851)	<b>1120-RIC</b>
S corporation (section 1361)	<b>1120S</b>
Settlement fund (section 468B)	<b>1120-SF</b>

### Ownership Interest in a FASIT

If a corporation holds an ownership interest in a **financial asset securitization investment trust (FASIT)**, it must report all items of income, gain, deductions, losses, and credits on the corporation's income tax return (except as provided in section 860H). Show a breakdown of the items on an attached schedule. For more information, see sections 860H and 860L.

### When To File

Generally, a corporation must file its income tax return by the 15th day of the 3rd month after the end of the tax year. A new corporation filing a short-period return must generally file by the 15th day of the 3rd month after the short period ends. A corporation that has dissolved must generally file by the 15th day of the 3rd month after the date it dissolved.

If the due date falls on a Saturday, Sunday, or legal holiday, the corporation may file on the next business day.

**Private delivery services.** Corporations can use certain private delivery services designated by the IRS to meet the “timely mailing as timely filing/paying” rule for tax returns and payments. The most recent list of designated private delivery services was published by the IRS in October 2001.

The list includes only the following:

- Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, Second Day Service.
- DHL Worldwide Express (DHL): DHL “Same Day” Service, DHL USA Overnight.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day.
- United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

The private delivery service can tell you how to get written proof of the mailing date.

**Extension.** File **Form 7004**, Application for Automatic Extension of Time To File

### Instructions for Forms 1120 and 1120-A

Corporation Income Tax Return, to request a 6-month extension of time to file.

## Who Must Sign

The return must be signed and dated by:

- The president, vice president, treasurer, assistant treasurer, chief accounting officer or
- Any other corporate officer (such as tax officer) authorized to sign.

Receivers, trustees, or assignees must also sign and date any return filed on behalf of a corporation.

If an employee of the corporation completes Form 1120 or Form 1120-A, the paid preparer's space should remain blank. In addition, anyone who prepares Form 1120 or Form 1120-A but does not charge the corporation should not complete that section. Generally, anyone who is paid to prepare the return must sign it and fill in the "Paid Preparer's Use Only" area.

The **paid preparer** must complete the required preparer information and—

- Sign the return, by hand, in the space provided for the preparer's signature (signature stamps and labels are not acceptable).
- Give a copy of the return to the taxpayer.

## Paid Preparer Authorization

If the corporation wants to allow the IRS to discuss its 2001 tax return with the paid preparer who signed it, check the "Yes" box

in the signature area of the return. This authorization applies only to the individual whose signature appears in the "Paid Preparer's Use Only" section of the corporation's return. It does not apply to the firm, if any, shown in that section.

If the "Yes" box is checked, the corporation is authorizing the IRS to call the paid preparer to answer any questions that may arise during the processing of its return. The corporation is also authorizing the paid preparer to:

- Give the IRS any information that is missing from the return,
- Call the IRS for information about the processing of the return or the status of any related refund or payment(s), and
- Respond to certain IRS notices that the corporation has shared with the preparer about math errors, offsets, and return preparation. The notices will not be sent to the preparer.

The corporation is not authorizing the paid preparer to receive any refund check, bind the corporation to anything (including any additional tax liability), or otherwise represent the corporation before the IRS. If the corporation wants to expand the paid preparer's authorization, see **Pub. 947**, Practice Before the IRS and Power of Attorney.

The authorization cannot be revoked. However, the authorization will automatically end no later than the due date (excluding extensions) for filing the corporation's 2002 tax return.

## Other Forms, Returns, and Statements That May Be Required

### Forms

The corporation may have to file some of the following forms. See the form for more information.

- **Form W-2**, Wage and Tax Statement, and **Form W-3**, Transmittal of Wage and Tax Statements. Use these forms to report wages, tips, and other compensation, and withheld income, social security, and Medicare taxes for employees.

- **Form W-2G**, Certain Gambling Winnings. Use this form to report gambling winnings from horse racing, dog racing, jai alai, lotteries, keno, bingo, slot machines, sweepstakes, wagering pools, etc.

- **Form 720**, Quarterly Federal Excise Tax Return. Use this form to report and pay the luxury tax on passenger vehicles, environmental taxes, communications and air transportation taxes, fuel taxes, manufacturers taxes, ship passenger taxes, and certain other excise taxes.

- **Form 851**, Affiliations Schedule. The parent corporation of an **affiliated group** of corporations must attach this form to its consolidated return. If this is the first year one or more subsidiaries are being included in a consolidated return, also see **Form 1122**, Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return, on page 4.

- **Form 926**, Return by a U.S. Transferor of Property to a Foreign Corporation. Use this form to report certain transfers to foreign corporations under section 6038B.

- **Form 940** or **Form 940-EZ**, Employer's Annual Federal Unemployment (FUTA) Tax Return. The corporation may be liable for FUTA tax and may have to file Form 940 or Form 940-EZ if either of the following applies.

1. It paid wages of \$1,500 or more in any calendar quarter in 2000 or 2001 or
2. It had at least one employee who worked for the corporation for some part of a day in 20 or more different weeks in 2000 or 20 or more different weeks in 2001.

- **Form 941**, Employer's Quarterly Federal Tax Return, or **Form 943**, Employer's Annual Tax Return for Agricultural Employees. Employers must file these forms to report income tax withheld, and employer and employee social security and Medicare taxes. Also, see **Trust fund recovery penalty** on page 7.

- **Form 945**, Annual Return of Withheld Federal Income Tax. File Form 945 to report income tax withheld from nonpayroll distributions or payments, including pensions, annuities, IRAs, gambling winnings, and backup withholding.

See **Trust fund recovery penalty** on page 7.

- **Form 952**, Consent To Extend Period of Limitation on Assessment of Income Taxes. This form is filed to extend the period of assessment of all income taxes of the receiving corporation on the complete liquidation of a subsidiary under section 332.

- **Form 966**, Corporate Dissolution or Liquidation. Use this form to report the

## Where To File

File the corporation's return at the applicable IRS address listed below.

If the corporation's principal business, office, or agency is located in:	And the total assets at the end of the tax year (Form 1120, page 1, item D) are:	Use the following Internal Revenue Service Center address:
Connecticut, Delaware, District of Columbia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, West Virginia, Wisconsin	Less than \$10 million	Cincinnati, OH 45999-0012
	\$10 million or more	Ogden, UT 84201-0012
Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Georgia, Hawaii, Idaho, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Texas, Utah, Washington, Wyoming	Any amount	Ogden, UT 84201-0012
A foreign country or U.S. possession (or the corporation is claiming the possessions corporation tax credit under sections 30A and 936)	Any amount	Philadelphia, PA 19255-0012

A group of corporations with members located in more than one service center area will often keep all the books and records at the principal office of the managing corporation. In this case, the tax returns of the corporations may be filed with the service center for the area in which the principal office of the managing corporation is located.

adoption of a resolution or plan to dissolve the corporation or liquidate any of its stock.

- **Form 1042**, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and
- **Form 1042-S**, Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and send withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent these payments constitute gross income from sources within the United States (see sections 861 through 865).

Also see **Pub. 515**, Withholding of Tax on Nonresident Aliens and Foreign Entities, and sections 1441 and 1442.

- **Form 1096**, Annual Summary and Transmittal of U.S. Information Returns.
- **Form 1098**, Mortgage Interest Statement. Use this form to report the receipt from any individual of \$600 or more of mortgage interest (including points) in the course of the corporation's trade or business and reimbursements of overpaid interest.
- **Form 1098-E**, Student Loan Interest Statement. Use this form to report the receipt of \$600 or more of student loan interest in the course of the corporation's trade or business.
- **Forms 1099**. Use these information returns to report the following:

1. **1099-A**, Acquisition or Abandonment of Secured Property.
2. **1099-B**, Proceeds From Broker and Barter Exchange Transactions.
3. **1099-C**, Cancellation of Debt.
4. **1099-DIV**, Dividends and Distributions.
5. **1099-INT**, Interest Income.
6. **1099-LTC**, Long-Term Care and Accelerated Death Benefits.
7. **1099-MISC**, Miscellaneous Income. Use this form to report payments: to certain fishing boat crew members, to providers of health and medical services, of rent or royalties, of nonemployee compensation, etc.

**Note:** Every corporation must file Form 1099-MISC if it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totaling \$600 or more to any one person in the course of its trade or business during the calendar year.

8. **1099-MSA**, Distributions From an Archer MSA or Medicare+Choice MSA.
9. **1099-OID**, Original Issue Discount.
10. **1099-PATR**, Taxable Distributions Received From Cooperatives.
11. **1099-R**, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
12. **1099-S**, Proceeds From Real Estate Transactions.

Also use these returns to report amounts received as a nominee for another person.

- **Form 1122**, Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return. For the first year a subsidiary corporation is being included in a consolidated return, attach the completed form to the parent's consolidated return. Attach a separate Form 1122 for each subsidiary being included in the consolidated return.
- **Form 3520**, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. Use this

form to report a distribution received from a foreign trust; or, if the corporation was the grantor of, transferor of, or transferor to, a foreign trust that existed during the tax year. See Question 5 of Schedule N (Form 1120).

- **Form 5452**, Corporate Report of Nondividend Distributions. Use this form to report nondividend distributions.
- **Form 5471**, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. This form is required if the corporation controls a foreign corporation; acquires, disposes of, or owns 10% or more in value or vote of the outstanding stock of a foreign corporation; or had control of a foreign corporation for an uninterrupted period of at least 30 days during the annual accounting period of the foreign corporation. See Question 4 of Schedule N (Form 1120).
- **Form 5472**, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. This form is filed if the corporation is 25% or more foreign-owned. See Question 7 on page 19.
- **Form 5498**, IRA Contribution Information. Use this form to report contributions (including rollover contributions) to any IRA, including a SEP, SIMPLE, Roth IRA, Coverdell ESA, and to report Roth conversions, IRA recharacterizations, and the fair market value of the account.
- **Form 5498-MSA**, Archer MSA or Medicare+Choice MSA Information. Use this form to report contributions to an Archer MSA and the fair market value of an Archer MSA or Medicare+Choice MSA.

For more information, see the general and specific Instructions for Forms 1099, 1098, 5498, and W-2G.

- **Form 5713**, International Boycott Report. Corporations that had operations in, or related to, certain "boycotting" countries file Form 5713.
- **Form 8027**, Employer's Annual Information Return of Tip Income and Allocated Tips. Use this form to report receipts from large food or beverage operations, tips reported by employees, and allocated tips.
- **Form 8264**, Application for Registration of a Tax Shelter. Tax shelter organizers use this form to receive a tax shelter registration number from the IRS.
- **Form 8271**, Investor Reporting of Tax Shelter Registration Number. Corporations, which have acquired an interest in a tax shelter that is required to be registered, use this form to report the tax shelter's registration number. Attach Form 8271 to any tax return (including an application for tentative refund (Form 1139) and an amended return) on which a deduction, credit, loss, or other tax benefit attributable to a tax shelter is taken or any income attributable to a tax shelter is reported.
- **Form 8275**, Disclosure Statement, and **Form 8275-R**, Regulation Disclosure Statement. Disclose items or positions taken on a tax return that are not otherwise adequately disclosed on a tax return or that are contrary to Treasury regulations (to avoid parts of the accuracy-related penalty or certain preparer penalties).
- **Form 8281**, Information Return for Publicly Offered Original Issue Discount Instruments. Use this form to report the issuance of public offerings of debt instruments (obligations).

- **Form 8300**, Report of Cash Payments Over \$10,000 Received in a Trade or Business. Use this form to report the receipt of more than \$10,000 in cash or foreign currency in one transaction or a series of related transactions.

- **Form 8594**, Asset Allocation Statement Under Sections 338 and 1060. Corporations file this form to report the purchase or sale of a group of assets that constitute a trade or business if goodwill or going concern value could attach to the assets and if the buyer's basis is determined only by the amount paid for the assets.

- **Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund. Use this form to make certain elections by shareholders in a passive foreign investment company and to figure certain deferred taxes.

- **Form 8697**, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts. This form is used to figure the interest due or to be refunded under the look-back method of section 460(b)(2). The look-back method applies to certain long-term contracts accounted for under the percentage of completion method or percentage of completion-capitalized cost method.

- **Form 8810**, Corporate Passive Activity Loss and Credit Limitations. Closely held corporations (and corporations that are personal service corporations) must use this form to compute the passive activity loss and credit allowed under section 469.

- **Form 8817**, Allocation of Patronage and Nonpatronage Income and Deductions. Use this form to figure and report patronage and nonpatronage income and deductions (used by taxable cooperatives).

- **Form 8842**, Election To Use Different Annualization Periods for Corporate Estimated Tax. Corporations use Form 8842 for each year they want to elect one of the annualization periods in section 6655(e)(2) for figuring estimated tax payments under the annualized income installment method.

- **Form 8849**, Claim for Refund of Excise Taxes. Corporations use this form to claim a refund of certain excise taxes.

- **Form 8865**, Return of U.S. Persons With Respect to Certain Foreign Partnerships. A domestic corporation may have to file Form 8865 if it:

1. Controlled a foreign partnership (i.e., owned more than a 50% direct or indirect interest in the partnership).

2. Owned at least a 10% direct or indirect interest in a foreign partnership while U.S. persons controlled that partnership.

3. Had an acquisition, disposition, or change in proportional interest in a foreign partnership that:

- a. Increased its direct interest to at least 10% or reduced its direct interest of at least 10% to less than 10%.

- b. Changed its direct interest by at least a 10% interest.

4. Contributed property to a foreign partnership in exchange for a partnership interest if:

- a. Immediately after the contribution, the corporation owned, directly or indirectly, at least a 10% interest in the foreign partnership or

b. The fair market value of the property the corporation contributed to the foreign partnership, when added to other contributions of property made to the foreign partnership during the preceding 12-month period, exceeds \$100,000.

Also, the domestic corporation may have to file Form 8865 to report certain dispositions by a foreign partnership of property it previously contributed to that partnership if it was a partner at the time of the disposition.

For more details, including penalties for failing to file Form 8865, see Form 8865 and its separate instructions.

• **Form 8866**, Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method. Figure the interest due or to be refunded under the look-back method of section 167(g)(2) for property placed in service after September 13, 1995, that is depreciated under the income forecast method.

## Amended Return

Use **Form 1120X**, Amended U.S. Corporation Income Tax Return, to correct a previously filed Form 1120 or Form 1120-A.

## Statements

**Consolidated returns.** File supporting statements for each corporation included in the consolidated return. Do not use Form 1120 as a supporting statement. On the supporting statement, use columns to show the following, both before and after adjustments:

1. Items of gross income and deductions.
2. A computation of taxable income.
3. Balance sheets as of the beginning and end of the tax year.
4. A reconciliation of income per books with income per return.
5. A reconciliation of retained earnings.

Enter the totals for the consolidated group on Form 1120. Attach consolidated balance sheets and a reconciliation of consolidated retained earnings. For more information on consolidated returns, see the regulations under section 1502.

**Corporate tax shelters.** A corporation is required to disclose its participation in certain tax shelters:

- By attaching a **disclosure statement** to its income tax return for a reportable transaction for each tax year its income tax liability is affected by its participation in the transaction and
- For the first tax year a disclosure statement is attached to its tax return, by sending a copy of the disclosure statement to the Internal Revenue Service, LM:PFTG:OTSA, Large & Mid-Size Business Division, 1111 Constitution Ave., NW, Washington, DC 20224.

Disclosure is required for reportable transactions that are: (a) listed transactions that the IRS has identified as tax avoidance transactions and (b) other reportable transactions that have tax shelter characteristics. A listed transaction must be reported if it is expected to reduce the taxpayer's income tax liability by more than \$1 million in a single tax year or by a total of more than \$2 million for any combination of

years. For other reportable transactions, the threshold increases to \$5 million for a single tax year or to \$10 million for any combination of years. Generally, reporting is not required for customary business transactions or transactions with tax benefits that the IRS has no reasonable basis to challenge.

See Temporary Regulations section 1.6011-4T for details, including:

- The definition of a reportable transaction and a listed transaction,
- The relevant tax shelter characteristics for other reportable transactions,
- The form and content of the disclosure statement, and
- The filing requirements of the disclosure statement.

Also see Notice 2001-51, 2001-34 I.R.B. 190, for certain listed transactions determined to have a tax avoidance purpose and the intended tax benefits that are subject to disallowance. The listed transactions in this notice may be updated from time to time when other tax avoidance transactions are identified.

**Stock ownership in foreign corporations.** Attach the statement required by section 551(c) if:

- The corporation owned 5% or more in value of the outstanding stock of a foreign personal holding company and
- The corporation was required to include in its gross income any undistributed foreign personal holding company income from a foreign personal holding company.

**Transfers to a corporation controlled by the transferor.** If a person receives stock of a corporation in exchange for property, and no gain or loss is recognized under section 351, the person (transferor) and the transferee must each attach to their tax returns the information required by Regulations section 1.351-3.

**Dual consolidated losses.** If a domestic corporation incurs a dual consolidated loss (as defined in Regulations section 1.1503-2(c)(5)), the corporation (or consolidated group) may need to attach an elective relief agreement and/or an annual certification as provided in Regulations section 1.1503-2(g)(2).

## Assembling the Return

To ensure that the corporation's tax return is correctly processed, attach all schedules and other forms after page 4, Form 1120 (or page 2, Form 1120-A), and in the following order.

1. Schedule N (Form 1120).
2. Form 8050.
3. Form 4136.
4. Form 4626.
5. Form 851.
6. Additional schedules in alphabetical order.
7. Additional forms in numerical order.

Complete every applicable entry space on Form 1120 or Form 1120-A. Do not write "See Attached" instead of completing the entry spaces. If more space is needed on the forms or schedules, attach separate sheets using the same size and format as the printed forms. If there are supporting statements and attachments, arrange them in the same order as the schedules or forms they support and attach them last. Show the

totals on the printed forms. Also, be sure to enter the corporation's name and EIN on each supporting statement or attachment.

## Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenses are reported.

Figure taxable income using the method of accounting regularly used in keeping the corporation's books and records. Generally, permissible methods include:

- Cash,
- Accrual, or
- Any other method authorized by the Internal Revenue Code.

In all cases, the method used must clearly show taxable income. If inventories are required, the accrual method must be used for sales and purchases of merchandise. However, qualifying taxpayers and eligible businesses of qualifying small business taxpayers are excepted from using the accrual method and may account for inventoriable items as materials and supplies that are not incidental. For details, see **Cost of Goods Sold** on page 14.

Generally, a corporation (other than a qualified personal service corporation) must use the accrual method of accounting if its average annual gross receipts exceed \$5 million. See section 448(c). A corporation engaged in farming operations must also use the accrual method. For exceptions, see section 447.

Under the accrual method, an amount is includible in income when:

- All the events have occurred that fix the right to receive the income, which is the earliest of the date: (a) the required performance takes place, (b) payment is due, or (c) payment is received and
- The amount can be determined with reasonable accuracy.

See Regulations section 1.451-1(a) for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year when:

- All events that determine the liability have occurred,
- The amount of the liability can be figured with reasonable accuracy, and
- Economic performance takes place with respect to the expense.

There are exceptions to the economic performance rule for certain items, including recurring expenses. See section 461(h) and the related regulations for the rules for determining when economic performance takes place.

Long-term contracts (except for certain real property construction contracts) must generally be accounted for using the percentage of completion method described in section 460. See section 460 and the underlying regulations for rules on long-term contracts.

### Mark-to-market accounting method.

Generally, dealers in securities must use the mark-to-market accounting method described in section 475. Under this method, any security that is inventory to the dealer must be included in inventory at its fair market value (FMV). Any security held by a dealer that is not inventory and that is held at the close of the tax year is treated as

sold at its FMV on the last business day of the tax year. Any gain or loss must be taken into account in determining gross income. The gain or loss taken into account is generally treated as ordinary gain or loss. For details, including exceptions, see section 475, the related regulations, and Rev. Rul. 94-7, 1994-1 C.B. 151.

**Dealers in commodities and traders in securities and commodities** may elect to use the mark-to-market accounting method. To make the election, the corporation must file a statement describing the election, the first tax year the election is to be effective, and, in the case of an election for traders in securities or commodities, the trade or business for which the election is made. Except for new taxpayers, the statement must be filed by the due date (not including extensions) of the income tax return for the tax year immediately **preceding** the election year and attached to that return, or if applicable, to a request for an extension of time to file that return. For more details, see Rev. Proc. 99-17, 1999-1 C.B. 503, and sections 475(e) and (f).

**Change in accounting method.** Generally, the corporation must get IRS consent to change the method of accounting used to report taxable income (for income as a whole or for any material item). To do so, it must file **Form 3115**, Application for Change in Accounting Method. For more information, see **Pub. 538**, Accounting Periods and Methods.

The corporation may also have to make an adjustment to prevent amounts of income or expense from being duplicated or omitted. This is called a **section 481(a) adjustment**, which is taken into account over a period not to exceed 4 years.

**Example.** A corporation changes to the cash method of accounting. It accrued sales in 2000 for which it received payment in 2001. It must report those sales in both years as a result of changing its accounting method and must make a section 481(a) adjustment to prevent duplication of income.

See Rev. Proc. 99-49, 1999-2 C.B. 725, to figure the amount of this adjustment for 2001. Include any positive section 481(a) adjustment on page 1, line 10. If the section 481(a) adjustment is negative, report it on Form 1120, line 26 (Form 1120-A, line 22).

## Accounting Periods

A corporation must figure its taxable income on the basis of a tax year. The tax year is the annual accounting period the corporation uses to keep its records and report its income and expenses. Generally, corporations can use a calendar year or a fiscal year. Personal service corporations, however, must use a calendar year unless they meet one of the exceptions discussed in **Accounting period** under **Personal Service Corporation** on page 7.

For more information about accounting periods, see Temporary Regulations sections 1.441-1T and 1.441-2T and Pub. 538.

**Calendar year.** If the calendar year is adopted as the annual accounting period, the corporation must maintain its books and records and report its income and expenses for the period from January 1 through December 31 of each year.

**Fiscal year.** A fiscal year is 12 consecutive months ending on the last day of any month except December. A 52–53-week year is a fiscal year that varies from 52 to 53 weeks.

**Adoption of tax year.** A corporation adopts a tax year when it files its first income tax return. It must adopt a tax year by the due date (not including extensions) of its first income tax return.

**Change of tax year.** Generally, a corporation must get the consent of the IRS before changing its tax year by filing **Form 1128**, Application To Adopt, Change, or Retain a Tax Year. However, under certain conditions, a corporation (other than a personal service corporation) may change its tax year without getting the consent. See Regulations section 1.442-1 and Pub. 538.

## Rounding Off to Whole Dollars

The corporation may show amounts on the return and accompanying schedules as whole dollars. To do so, drop amounts less than 50 cents and increase amounts from 50 cents through 99 cents to the next higher dollar.

## Recordkeeping

Keep the corporation's records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Usually, records that support an item of income, deduction, or credit on the return must be kept for 3 years from the date the return is due or filed, whichever is later. Keep records that verify the corporation's basis in property for as long as they are needed to figure the basis of the original or replacement property.

The corporation should keep copies of all filed returns. They help in preparing future and amended returns.

## Depository Method of Tax Payment

The corporation must pay the tax due in full no later than the 15th day of the 3rd month after the end of the tax year. The two methods of depositing corporate income taxes are discussed below.

## Electronic Deposit Requirement

The corporation must make electronic deposits of **all** depository taxes (such as employment tax, excise tax, and corporate income tax) using the Electronic Federal Tax Payment System (EFTPS) in 2002 if:

- The total deposits of such taxes in 2000 were more than \$200,000 or
- The corporation was required to use EFTPS in 2001.

If the corporation is required to use EFTPS and fails to do so, it may be subject to a 10% penalty. If the corporation is not required to use EFTPS, it may participate voluntarily. To enroll in or get more information about EFTPS, call 1-800-555-4477 or 1-800-945-8400. To enroll online, visit [www.eftps.gov](http://www.eftps.gov).

**Depositing on time.** For EFTPS deposits to be made timely, the corporation must initiate the transaction at least 1 business day before the date the deposit is due.

## Deposits With Form 8109

If the corporation does not use EFTPS, deposit corporation income tax payments (and estimated tax payments) with **Form 8109**, Federal Tax Deposit Coupon. If you do not have a preprinted Form 8109, use Form 8109-B to make deposits. You can get this form by calling 1-800-829-1040. Be sure to have your EIN ready when you call.

Do not send deposits directly to an IRS office; otherwise, the corporation may have to pay a penalty. Mail or deliver the completed Form 8109 with the payment to an authorized depository, i.e., a commercial bank or other financial institution authorized to accept Federal tax deposits. Make checks or money orders payable to the depository.

If the corporation prefers, it may mail the coupon and payment to: Financial Agent, Federal Tax Deposit Processing, P.O. Box 970030, St. Louis, MO 63197. Make the check or money order payable to "Financial Agent."

To help ensure proper crediting, write the corporation's EIN, the tax period to which the deposit applies, and "Form 1120" on the check or money order. Be sure to darken the "1120" box on the coupon. Records of these deposits will be sent to the IRS.

For more information on deposits, see the instructions in the coupon booklet (Form 8109) and **Pub. 583**, Starting a Business and Keeping Records.



*If the corporation owes tax when it files Form 1120 or Form 1120-A, do not include the payment with the tax return. Instead, mail or deliver the payment with Form 8109 to an authorized depository, or use EFTPS, if applicable.*

## Estimated Tax Payments

Generally, the following rules apply to the corporation's payments of estimated tax.

- The corporation must make installment payments of estimated tax if it expects its total tax for the year (less applicable credits) to be \$500 or more.
- The installments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year. If any date falls on a Saturday, Sunday, or legal holiday, the installment is due on the next regular business day.
- Use **Form 1120-W**, Estimated Tax for Corporations, as a worksheet to compute estimated tax.
- If the corporation does not use EFTPS, use the deposit coupons (Forms 8109) to make deposits of estimated tax.

For more information on estimated tax payments, including penalties that apply if the corporation fails to make required payments, see the instructions for line 33 on page 14.

**Overpaid estimated tax.** If the corporation overpaid estimated tax, it may be able to get a quick refund by filing **Form 4466**, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The overpayment must be at least 10% of the corporation's expected income tax liability and at least \$500. File Form 4466 before the 16th day of the 3rd month after the end of the tax year, but before the corporation files

its income tax return. Do not file Form 4466 before the end of the corporation's tax year.

## Interest and Penalties

**Interest.** Interest is charged on taxes paid late even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

**Penalty for late filing of return.** A corporation that does not file its tax return by the due date, including extensions, may be penalized 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is over 60 days late is the smaller of the tax due or \$100. The penalty will not be imposed if the corporation can show that the failure to file on time was due to reasonable cause. Corporations that file late must attach a statement explaining the reasonable cause.

**Penalty for late payment of tax.** A corporation that does not pay the tax when due generally may be penalized 1/2 of 1% of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax. The penalty will not be imposed if the corporation can show that the failure to pay on time was due to reasonable cause.

**Trust fund recovery penalty.** This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid. These taxes are generally reported on Forms 720, 941, 943, or 945 (see **Other Forms, Returns, and Statements That May Be Required** on page 3). The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the Instructions for Form 720, **Pub. 15** (Circular E), Employer's Tax Guide, or **Pub. 51** (Circular A), Agricultural Employer's Tax Guide, for details, including the definition of responsible persons.

**Other penalties.** Other penalties can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6662 and 6663.

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## Specific Instructions

### Period Covered

File the 2001 return for calendar year 2001 and fiscal years that begin in 2001 and end in 2002. For a fiscal year return, fill in the tax year space at the top of the form.

**Note:** The 2001 Form 1120 may also be used if:

- The corporation has a tax year of less than 12 months that begins and ends in 2002 and
- The 2002 Form 1120 is not available at the time the corporation is required to file its return.

The corporation must show its 2002 tax year on the 2001 Form 1120 and take into account any tax law changes that are effective for tax years beginning after December 31, 2001.

### Name

Use the preprinted label on the tax package information form (Form 8160-A) or the Form 1120 package that was mailed to the corporation. Cross out any errors and print the correct information on the label. If the corporation did not receive a label, print or type the corporation's true name (as set forth in the charter or other legal document creating it), address, and EIN on the appropriate lines.

### Address

Include the suite, room, or other unit number after the street address. If a preaddressed label is used, include this information on the label. If the Post Office does not deliver mail to the street address and the corporation has a P.O. box, show the box number instead.

### Item A

#### Consolidated Return (Form 1120 Only)

Corporations filing a consolidated return must attach Form 851 and other supporting statements to the return. For details, see **Other Forms, Returns, and Statements That May Be Required** on page 3, and **Statements** on page 5.

#### Personal Holding Company (Form 1120 Only)

A personal holding company must attach to Form 1120 a **Schedule PH (Form 1120)**, U.S. Personal Holding Company (PHC) Tax. See the instructions for that form for details.

#### Personal Service Corporation

A personal service corporation is a corporation whose principal activity (defined below) for the testing period for the tax year is the performance of personal services. The services must be substantially performed by employee-owners. Employee-owners must own more than 10% of the fair market value of the corporation's outstanding stock on the last day of the testing period.

**Testing period.** Generally, the testing period for a tax year is the prior tax year. The testing period for a new corporation starts with the first day of its first tax year and ends on the **earlier** of:

- The last day of its first tax year or
- The last day of the calendar year in which the first tax year began.

**Principal activity.** The principal activity of a corporation is considered to be the performance of personal services if, during the testing period, the corporation's compensation costs for the performance of

personal services (defined below) are more than 50% of its total compensation costs.

#### Performance of personal services.

Personal services are those performed in the health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting fields (as defined in Temporary Regulations section 1.448-1T(e)). The term "performance of personal services" includes any activity involving the performance of personal services in these fields.

#### Substantial performance by employee-owners.

Personal services are substantially performed by employee-owners if, for the testing period, more than 20% of the corporation's compensation costs for the performance of personal services are for services performed by employee-owners.

**Employee-owner.** A person is considered to be an employee-owner if the person:

- Is an employee of the corporation on any day of the testing period and
- Owns any outstanding stock of the corporation on any day of the testing period. Stock ownership is determined under the attribution rules of section 318, except that "any" is substituted for "50%" in section 318(a)(2)(C).

**Accounting period.** A personal service corporation must use a calendar tax year unless:

- It can establish a business purpose for a different tax year (see Rev. Proc. 87-32, 1987-2 C.B. 396, and Rev. Rul. 87-57, 1987-2 C.B. 117) or
- It elects under section 444 to have a tax year other than a calendar year. To make the election, see **Form 8716**, Election To Have a Tax Year Other Than a Required Tax Year.

Personal service corporations that want to change their tax year must also file Form 1128.

If a corporation makes the section 444 election, its deduction for certain amounts paid to employee-owners may be limited. See **Schedule H (Form 1120)**, Section 280H Limitations for a Personal Service Corporation (PSC), to figure the maximum deduction.

If a section 444 election is terminated and the termination results in a short tax year, type or print at the top of the first page of Form 1120 or 1120-A for the short tax year "SECTION 444 ELECTION TERMINATED." See Temporary Regulations section 1.444-1T(a)(5) for more information.

For more information about personal service corporations, see Temporary Regulations section 1.441-4T.

**Other rules.** For other rules that apply to personal service corporations, see **Passive activity limitations** on page 9 and **Contributions of property other than cash** on page 11.

### Item B—Employer Identification Number (EIN)

Enter the corporation's EIN. If the corporation does not have an EIN, it must apply for one on **Form SS-4**, Application for Employer Identification Number. If the corporation has not received its EIN by the

time the return is due, write “Applied for” in the space for the EIN. See Pub. 583 for details.

## Item D—Total Assets

Enter the corporation’s total assets (as determined by the accounting method regularly used in keeping the corporation’s books and records) at the end of the tax year. If there are no assets at the end of the tax year, enter the total assets as of the beginning of the tax year.

## Item E—Initial Return, Final Return, Name Change, or Address Change

- If this is the corporation’s first return, check the “Initial return” box.
- If the corporation ceases to exist, file Form 1120 and check the “Final return” box. Do not file Form 1120-A.
- If the corporation changed its name since it last filed a return, check the box for “Name change.” Generally, a corporation also must have amended its articles of incorporation and filed the amendment with the state in which it was incorporated.
- If the corporation has changed its address since it last filed a return, check the box for “Address change.”

**Note:** If a **change in address** occurs after the return is filed, use **Form 8822, Change of Address**, to notify the IRS of the new address.

## Income

Except as otherwise provided in the Internal Revenue Code, gross income includes all income from whatever source derived. Gross income, however, does not include **extraterritorial income** that is qualifying foreign trade income. Use **Form 8873, Extraterritorial Income Exclusion**, to figure the exclusion. Report it on Form 1120 or 1120-A as explained in the Instructions for Form 8873.

### Line 1

#### Gross Receipts

Enter gross receipts or sales from all business operations except those that must be reported on lines 4 through 10. In general, advance payments are reported in the year of receipt. To report income from long-term contracts, see section 460. For special rules for reporting certain advance payments for goods and long-term contracts, see Regulations section 1.451-5. For permissible methods for reporting advance payments for services by an accrual method corporation, see Rev. Proc. 71-21, 1971-2 C.B. 549.

**Installment sales.** Generally, the installment method cannot be used for dealer dispositions of property. A “dealer disposition” is: (a) any disposition of personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan or (b) any disposition of real property held for sale to customers in the ordinary course of the taxpayer’s trade or business.

These restrictions on using the installment method do not apply to dispositions of property used or produced in a farming business or sales of timeshares and residential lots for which the corporation elects to pay interest under section 453(l)(3).

For sales of timeshares and residential lots reported under the installment method, the corporation’s income tax is increased by the interest payable under section 453(l)(3). To report this addition to the tax, see the instructions for line 10, Schedule J, Form 1120.

Enter on line 1 (and carry to line 3), the gross profit on collections from installment sales for any of the following:

- Dealer dispositions of property before March 1, 1986.
- Dispositions of property used or produced in the trade or business of farming.
- Certain dispositions of timeshares and residential lots reported under the installment method.

Attach a schedule showing the following information for the current and the 3 preceding years: (a) gross sales, (b) cost of goods sold, (c) gross profits, (d) percentage of gross profits to gross sales, (e) amount collected, and (f) gross profit on the amount collected.

**Nonaccrual experience method.** Accrual method taxpayers need not accrue certain amounts to be received from the performance of services that, on the basis of their experience, will not be collected (section 448(d)(5)). This provision does not apply to any amount if interest is required to be paid on the amount or if there is any penalty for failure to timely pay the amount. Corporations that fall under this provision should attach a schedule showing total gross receipts, the amount not accrued as a result of the application of section 448(d)(5), and the net amount accrued. Enter the net amount on line 1a. For more information and guidelines on this “nonaccrual experience method,” see Temporary Regulations section 1.448-2T.

### Line 2

#### Cost of Goods Sold

Enter the cost of goods sold on line 2, page 1. Before making this entry, a Form 1120 filer must complete Schedule A on page 2 of Form 1120. See the Schedule A instructions on page 14. Form 1120-A filers may use the worksheet on page 14 to figure the amount to enter on line 2.

### Line 4

#### Dividends

**Form 1120 filers.** See the instructions for Schedule C on page 15. Then, complete Schedule C and enter on line 4 the amount from Schedule C, line 19.

**Form 1120-A filers.** Enter the total dividends received (that are not from debt-financed stock) from domestic corporations that qualify for the 70% dividends-received deduction.

### Line 5

#### Interest

Enter taxable interest on U.S. obligations and on loans, notes, mortgages, bonds, bank deposits, corporate bonds, tax refunds, etc.

Do not offset interest expense against interest income.

Special rules apply to interest income from certain below-market-rate loans. See section 7872 for more information.

### Line 6

#### Gross Rents

Enter the gross amount received for the rental of property. Deduct expenses such as repairs, interest, taxes, and depreciation on the proper lines for deductions. A rental activity held by a closely held corporation or a personal service corporation may be subject to the passive activity loss rules. See Form 8810 and its instructions.

### Line 8

#### Capital Gain Net Income

Every sale or exchange of a capital asset must be reported in detail on **Schedule D (Form 1120)**, Capital Gains and Losses, even if there is no gain or loss.

### Line 9

#### Net Gain or (Loss)

Enter the net gain or (loss) from line 18, Part II, **Form 4797**, Sales of Business Property.

### Line 10

#### Other Income

Enter any other taxable income not reported on lines 1 through 9. List the type and amount of income on an attached schedule. If the corporation has only one item of other income, describe it in parentheses on line 10. Examples of other income to report on line 10 are:

- Recoveries of bad debts deducted in prior years under the specific charge-off method.
- The amount of credit for alcohol used as fuel (determined without regard to the limitation based on tax) entered on **Form 6478, Credit for Alcohol Used as Fuel**.
- Refunds of taxes deducted in prior years to the extent they reduced income subject to tax in the year deducted (see section 111). Do not offset current year taxes against tax refunds.
- The amount of any deduction previously taken under section 179A that is subject to recapture. The corporation must recapture the benefit of any allowable deduction for clean-fuel vehicle property (or clean-fuel vehicle refueling property), if the property later ceases to qualify. See Regulations section 1.179A-1 for details.
- Ordinary income from trade or business activities of a partnership (from Schedule K-1 (Form 1065 or 1065-B)). Do not offset ordinary losses against ordinary income. Instead, include the losses on line 26, Form 1120, or line 22, Form 1120-A. Show the partnership’s name, address, and EIN on a separate statement attached to this return. If the amount entered is from more than one

partnership, identify the amount from each partnership.

- Any **LIFO recapture amount** under section 1363(d). The corporation may have to include a LIFO recapture amount in income if it:

1. Used the LIFO inventory method for its last tax year before the first tax year for which it elected to become an S corporation or

2. Transferred LIFO inventory assets to an S corporation in a nonrecognition transaction in which those assets were transferred basis property.

The LIFO recapture amount is the amount by which the C corporation's inventory under the FIFO method exceeds the inventory amount under the LIFO method at the close of the corporation's last tax year as a C corporation (or for the year of the transfer, if 2 above applies). For more information, see Regulations section 1.1363-2 and Rev. Proc. 94-61, 1994-2 C.B. 775. Also see the instructions for Schedule J, line 11.

## Deductions

### Limitations on Deductions

**Section 263A uniform capitalization rules.** The uniform capitalization rules of section 263A require corporations to capitalize, or include in inventory, certain costs incurred in connection with:

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a corporation for use in its trade or business or in an activity engaged in for profit.

**Tangible personal property** produced by a corporation includes a film, sound recording, videotape, book, or similar property.

Corporations subject to the section 263A uniform capitalization rules are required to capitalize:

1. Direct costs and
2. An allocable part of most indirect costs (including taxes) that (a) benefit the assets produced or acquired for resale or (b) are incurred by reason of the performance of production or resale activities.

For inventory, some of the **indirect expenses** that must be capitalized are:

- Administration expenses.
- Taxes.
- Depreciation.
- Insurance.
- Compensation paid to officers attributable to services.
- Rework labor.
- Contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

Regulations section 1.263A-1(e)(3) specifies other indirect costs that relate to production or resale activities that must be capitalized and those that may be currently deductible.

**Interest expense** paid or incurred during the production period of designated property must be capitalized and is governed by special rules. For more details, see Regulations sections 1.263A-8 through 1.263A-15.

The costs required to be capitalized under section 263A are not deductible until the property (to which the costs relate) is sold, used, or otherwise disposed of by the corporation.

**Exceptions.** Section 263A **does not** apply to:

- Personal property acquired for resale if the corporation's average annual gross receipts for the 3 prior tax years were \$10 million or less.
- Timber.
- Most property produced under a long-term contract.
- Certain property produced in a farming business.
- Research and experimental costs under section 174.
- Intangible drilling costs for oil, gas, and geothermal property.
- Mining exploration and development costs.
- Inventoriable items accounted for in the same manner as materials and supplies that are not incidental. See **Cost of Goods Sold** on page 14 for details.

For more details on the uniform capitalization rules, see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

**Transactions between related taxpayers.** Generally, an accrual basis taxpayer may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. See sections 163(e)(3), 163(j), and 267 for limitations on deductions for unpaid interest and expenses.

**Section 291 limitations.** Corporations may be required to adjust deductions for depletion of iron ore and coal, intangible drilling and exploration and development costs, certain deductions for financial institutions, and the amortizable basis of pollution control facilities. See section 291 to determine the amount of the adjustment. Also see section 43.

**Golden parachute payments.** A portion of the payments made by a corporation to key personnel that exceeds their usual compensation may not be deductible. This occurs when the corporation has an agreement (golden parachute) with these key employees to pay them these excess amounts if control of the corporation changes. See section 280G.

**Business startup expenses.** Business startup expenses must be capitalized unless an election is made to amortize them over a period of 60 months. See section 195 and Regulations section 1.195-1.

**Passive activity limitations.** Limitations on passive activity losses and credits under section 469 apply to personal service corporations as defined in Temporary Regulations section 1.441-4T (see **Personal Service Corporation** on page 7 and **Closely held corporations** below).

Generally, the two kinds of passive activities are:

- Trade or business activities in which the corporation did not materially participate for the tax year (see Temporary Regulations section 1.469-1T(g)(3)) and
- Rental activities regardless of its participation.

For exceptions, see Form 8810.

An activity is a trade or business activity if it is not a rental activity, and

- The activity involves the conduct of a trade or business (i.e., deductions from the activity would be allowable under section 162 if other limitations, such as the passive loss rules, did not apply) or
- The activity involves research and experimental costs that are deductible under section 174 (or would be deductible if the corporation chose to deduct rather than capitalize them).

Corporations subject to the passive activity limitations must complete Form 8810 to compute their allowable passive activity loss and credit. Before completing Form 8810, see Temporary Regulations section 1.163-8T, which provides rules for allocating interest expense among activities. If a passive activity is also subject to the earnings stripping rules of section 163(j) or the at-risk rules of section 465, those rules apply before the passive loss rules. For more information, see section 469, the related regulations, and **Pub. 925**, Passive Activity and At-Risk Rules.

**Closely held corporations.** For this purpose, a corporation is a closely held corporation if:

- At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals and
- The corporation is not a personal service corporation.

Certain organizations are treated as individuals for purposes of this test. See section 542(a)(2). For rules for determining stock ownership, see section 544 (as modified by section 465(a)(3)).

**Reducing certain expenses for which credits are allowable.** For each credit listed below, the corporation must reduce the otherwise allowable deductions for expenses used to figure the credit by the amount of the current year credit:

- Work opportunity credit.
- Research credit.
- Enhanced oil recovery credit.
- Disabled access credit.
- Empowerment zone employment credit.
- Indian employment credit.
- Employer credit for social security and Medicare taxes paid on certain employee tips.
- Orphan drug credit.
- Welfare-to-work credit.

If the corporation has any of these credits, figure each current year credit before figuring the deduction for expenses on which the credit is based.

## Line 12

### Compensation of Officers

Enter deductible officers' compensation on line 12. Form 1120 filers must complete Schedule E if their total receipts (line 1a, plus lines 4 through 10) are \$500,000 or more. Do not include compensation

deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement or a SIMPLE IRA plan.

Include only the deductible part of each officer's compensation on Schedule E. See **Disallowance of deduction for employee compensation in excess of \$1 million** below. Complete Schedule E, line 1, columns (a) through (f), for all officers. The corporation determines who is an officer under the laws of the state where it is incorporated.

If a consolidated return is filed, each member of an affiliated group must furnish this information.

**Disallowance of deduction for employee compensation in excess of \$1 million.** Publicly held corporations may not deduct compensation to a "covered employee" to the extent that the compensation exceeds \$1 million. Generally, a covered employee is:

- The chief executive officer of the corporation (or an individual acting in that capacity) as of the end of the tax year or
- An employee whose total compensation must be reported to shareholders under the Securities Exchange Act of 1934 because the employee is among the four highest compensated officers for that tax year (other than the chief executive officer).

For this purpose, compensation does not include the following:

- Income from certain employee trusts, annuity plans, or pensions and
- Any benefit paid to an employee that is excluded from the employee's income.

The deduction limit does not apply to:

- Commissions based on individual performance,
- Qualified performance-based compensation, and
- Income payable under a written, binding contract in effect on February 17, 1993.

The \$1-million limit is reduced by amounts disallowed as excess parachute payments under section 280G.

For details, see section 162(m) and Regulations section 1.162-27.

## Line 13

### Salaries and Wages

Enter the amount of salaries and wages paid for the tax year, reduced by:

- Any work opportunity credit from Form 5884,
- Any empowerment zone employment credit from Form 8844,
- Any Indian employment credit from Form 8845, and
- Any welfare-to-work credit from Form 8861.

See the instructions for these forms for more information. Do not include salaries and wages deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement or a SIMPLE IRA plan.



*If the corporation provided taxable fringe benefits to its employees, such as personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses claimed on lines 20 and 26, Form 1120, or lines 20 and 22, Form 1120-A.*

## Line 14

### Repairs and Maintenance

Enter the cost of incidental repairs and maintenance not claimed elsewhere on the return, such as labor and supplies, that do not add to the value of the property or appreciably prolong its life. New buildings, machinery, or permanent improvements that increase the value of the property are not deductible. They must be depreciated or amortized.

## Line 15

### Bad Debts

Enter the total debts that became worthless in whole or in part during the tax year. A small bank or thrift institution using the reserve method of section 585 should attach a schedule showing how it figured the current year's provision. A cash basis taxpayer may not claim a bad debt deduction unless the amount was previously included in income.

## Line 16

### Rents

If the corporation rented or leased a vehicle, enter the total annual rent or lease expense paid or incurred during the year. Also complete Part V of **Form 4562**, Depreciation and Amortization. If the corporation leased a vehicle for a term of 30 days or more, the deduction for vehicle lease expense may have to be reduced by an amount called the **inclusion amount**. The corporation may have an inclusion amount if:

**And the  
vehicle's FMV on  
the first day of  
the lease  
exceeded:**

**The lease term began:**

After 12/31/98 . . . . .	\$15,500
After 12/31/96 but before 1/1/99 . . . .	\$15,800
After 12/31/94 but before 1/1/97 . . . .	\$15,500
After 12/31/93 but before 1/1/95 . . . .	\$14,600

If the lease term began before January 1, 1994, or, the leased vehicle was an electric vehicle, see **Pub. 463**, Travel, Entertainment, Gift, and Car Expenses, to find out if the corporation has an inclusion amount.

See Pub. 463 for instructions on figuring the inclusion amount.

## Line 17

### Taxes and Licenses

Enter taxes paid or accrued during the tax year, but do not include the following:

- Federal income taxes.
- Foreign or U.S. possession income taxes if a tax credit is claimed (however, see the Instructions for Form 5735 for special rules for possession income taxes).

- Taxes not imposed on the corporation.
- Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (these taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition).

- Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.).
- Taxes deducted elsewhere on the return, such as those reflected in cost of goods sold.

See section 164(d) for apportionment of taxes on real property between seller and purchaser.

## Line 18

### Interest

**Note:** *The deduction for interest is limited when the corporation is a policyholder or beneficiary with respect to a life insurance, endowment, or annuity contract issued after June 8, 1997. For details, see section 264(f). Attach a statement showing the computation of the deduction.*

The corporation must make an interest allocation if the proceeds of a loan were used for more than one purpose (e.g., to purchase a portfolio investment and to acquire an interest in a passive activity). See Temporary Regulations section 1.163-8T for the interest allocation rules.

Mutual savings banks, building and loan associations, and cooperative banks can deduct the amounts paid or credited to the accounts of depositors as dividends, interest, or earnings. See section 591.

**Do not** deduct the following interest:

- Interest on indebtedness incurred or continued to purchase or carry obligations if the interest is wholly exempt from income tax. For exceptions, see section 265(b).
- For cash basis taxpayers, prepaid interest allocable to years following the current tax year (e.g., a cash basis calendar year taxpayer who in 2001 prepaid interest allocable to any period after 2001 can deduct only the amount allocable to 2001).
- Interest and carrying charges on straddles. Generally, these amounts must be capitalized. See section 263(g).
- Interest on debt allocable to the production of designated property by a corporation for its own use or for sale. The corporation must capitalize this interest. Also capitalize any interest on debt allocable to an asset used to produce the property. See section 263A(f) and Regulations section 1.263A-8 through 1.263A-15 for definitions and more information.

Special rules apply to:

- Interest on which no tax is imposed (see section 163(j)).
- Foregone interest on certain below-market-rate loans (see section 7872).
- Original issue discount on certain high-yield discount obligations. (See section 163(e) to figure the disqualified portion.)

## Line 19

### Charitable Contributions

Enter contributions or gifts actually paid within the tax year to or for the use of charitable and governmental organizations

described in section 170(c) and any unused contributions carried over from prior years.

Corporations reporting taxable income on the accrual method may elect to treat as paid during the tax year any contributions paid by the 15th day of the 3rd month after the end of the tax year if the contributions were authorized by the board of directors during the tax year. Attach a declaration to the return, signed by an officer, stating that the resolution authorizing the contributions was adopted by the board of directors during the tax year. Also attach a copy of the resolution.

**Limitation on deduction.** The total amount claimed may not be more than 10% of taxable income (line 30, Form 1120, or line 26, Form 1120-A) computed without regard to the following:

- Any deduction for contributions,
- The special deductions on line 29b, Form 1120 (line 25b, Form 1120-A),
- The deduction allowed under section 249,
- Any net operating loss (NOL) carryback to the tax year under section 172, and
- Any capital loss carryback to the tax year under section 1212(a)(1).

**Carryover.** Charitable contributions over the 10% limitation may not be deducted for the tax year but may be carried over to the next 5 tax years.

Special rules apply if the corporation has an NOL carryover to the tax year. In figuring the charitable contributions deduction for the tax year, the 10% limit is applied using the taxable income after taking into account any deduction for the NOL.

To figure the amount of any remaining NOL carryover to later years, taxable income must be modified (see section 172(b)). To the extent that contributions are used to reduce taxable income for this purpose and increase an NOL carryover, a contributions carryover is not allowed. See section 170(d)(2)(B).

**Substantiation requirements.** Generally, no deduction is allowed for any contribution of \$250 or more unless the corporation gets a written acknowledgment from the donee organization that shows the amount of cash contributed, describes any property contributed, and, either gives a description and a good faith estimate of the value of any goods or services provided in return for the contribution or states that no goods or services were provided in return for the contribution. The acknowledgment must be obtained by the due date (including extensions) of the corporation's return, or, if earlier, the date the return is filed. Do not attach the acknowledgment to the tax return, but keep it with the corporation's records. These rules apply in addition to the filing requirements for **Form 8283**, Noncash Charitable Contributions, described below.

For more information on substantiation and recordkeeping requirements, see the regulations under section 170 and **Pub. 526**, Charitable Contributions.

#### **Contributions to organizations conducting lobbying activities.**

Contributions made to an organization that conducts lobbying activities are not deductible if:

- The lobbying activities relate to matters of direct financial interest to the donor's trade or business and

- The principal purpose of the contribution was to avoid Federal income tax by obtaining a deduction for activities that would have been nondeductible under the lobbying expense rules if conducted directly by the donor.

#### **Contributions of property other than cash.**

If a corporation (other than a closely held or personal service corporation) contributes property other than cash and claims over a \$500 deduction for the property, it must attach a schedule to the return describing the kind of property contributed and the method used to determine its fair market value (FMV). Closely held corporations and personal service corporations must complete Form 8283 and attach it to their returns. All other corporations generally must complete and attach Form 8283 to their returns for contributions of property (other than money) if the total claimed deduction for all property contributed was more than \$5,000.

If the corporation made a "qualified conservation contribution" under section 170(h), also include the FMV of the underlying property before and after the donation, as well as the type of legal interest contributed, and describe the conservation purpose benefited by the donation. If a contribution carryover is included, show the amount and how it was determined.

#### **Reduced deduction for contributions of certain property.**

For a charitable contribution of property, the corporation must reduce the contribution by the sum of:

- The ordinary income and short-term capital gain that would have resulted if the property were sold at its FMV and
- For certain contributions, the long-term capital gain that would have resulted if the property were sold at its FMV.

The reduction for the long-term capital gain applies to:

- Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption and
- Contributions of any property to or for the use of certain private foundations except for stock for which market quotations are readily available (section 170(e)(5)).

**Larger deduction.** A larger deduction is allowed for certain contributions of:

- Inventory and other property to certain organizations for use in the care of the ill, needy, or infants (see section 170(e)(3) and Regulations section 1.170A-4A);
- Scientific equipment used for research to institutions of higher learning or to certain scientific research organizations (other than by personal holding companies and service organizations) (see section 170(e)(4)); and
- Computer technology and equipment for educational purposes.

#### **Contributions of computer technology and equipment for educational purposes.**

A corporation may take an increased deduction under section 170(e)(6) for qualified contributions of computer technology or equipment for educational purposes. **Computer technology or equipment** means computer software, computer or peripheral equipment, and fiber optic cable related to computer use. A contribution is a qualified contribution if:

- It is made to an eligible donee (see below);

- Substantially all of the donee property's use is:

1. Related to the purpose or function of the donee;
  2. For use within the United States; and
  3. For educational purposes.
- The contribution is made not later than 3 years after the date the taxpayer acquired or substantially completed the construction of the property;
  - The original use of the property is by the donor or the donee;
  - The property is not transferred by the donee for money, services, or other property, except for shipping, transfer, and installation costs;
  - The property fits productively into the donee's education plan; and
  - The property meets standards, if any, that may be prescribed by future regulations, to assure it meets minimum functionality and suitability for educational purposes.

**Eligible donee.** The term "eligible donee" means:

- An educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils in attendance at the place where its educational activities are regularly conducted,
- A section 501(c)(3) entity organized primarily for purposes of supporting elementary and secondary education, or
- A public library (as described in section 170(e)(6)(B)(i)(III)).

**Exceptions.** The following exceptions apply to the above rules for computer technology and equipment:

- Contributions to private foundations may qualify if the foundation contributes the property to an eligible donee within 30 days after the contribution and notifies the donor of the contribution. For more details, see section 170(e)(6)(C).
- For contributions of property reacquired by the manufacturer of the property, the 3 year period begins on the date that the original construction of the property was substantially completed. Also, the original use of the property may be by someone other than the donor or the donee.

## **Line 20**

### **Depreciation**

Besides depreciation, include on line 20 the part of the cost that the corporation elected to expense under section 179 for certain tangible property placed in service during tax year 2001 or carried over from 2000. See Form 4562 and its instructions.

## **Line 22 (Form 1120 Only)**

### **Depletion**

See sections 613 and 613A for percentage depletion rates applicable to natural deposits. Also, see section 291 for the limitation on the depletion deduction for iron ore and coal (including lignite).

Attach **Form T (Timber)**, Forest Activities Schedules, if a deduction for depletion of timber is taken.

Foreign intangible drilling costs and foreign exploration and development costs must either be added to the corporation's basis for cost depletion purposes or be

deducted ratably over a 10-year period. See sections 263(i), 616, and 617 for details.

## Line 24 (Form 1120 Only)

### Pension, Profit-Sharing, etc., Plans

Enter the deduction for contributions to qualified pension, profit-sharing, or other funded deferred compensation plans. Employers who maintain such a plan generally must file one of the forms listed below, even if the plan is not a qualified plan under the Internal Revenue Code. The filing requirement applies even if the corporation does not claim a deduction for the current tax year. There are penalties for failure to file these forms on time and for overstating the pension plan deduction. See sections 6652(e) and 6662(f).

**Form 5500**, Annual Return/Report of Employee Benefit Plan. File this form for a plan that is not a one-participant plan (see below).

**Form 5500-EZ**, Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan. File this form for a plan that only covers the owner (or the owner and his or her spouse) but only if the owner (or the owner and his or her spouse) owns the entire business.

## Line 25 (Form 1120 Only)

### Employee Benefit Programs

Enter contributions to employee benefit programs not claimed elsewhere on the return (e.g., insurance, health and welfare programs, etc.) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 24.

## Line 26, Form 1120 (Line 22, Form 1120-A)

### Other Deductions

Attach a schedule, listing by type and amount, all allowable deductions that are not deductible elsewhere on Form 1120 or Form 1120-A. Form 1120-A filers should include amounts described in the instructions above for lines 22, 24, and 25 of Form 1120. Enter the total of other deductions on line 26, Form 1120 (line 22, Form 1120-A).

Examples of other deductions include:

- Amortization of pollution control facilities, organization expenses, etc. (see Form 4562).
- Insurance premiums.
- Legal and professional fees.
- Supplies used and consumed in the business.
- Utilities.
- Ordinary losses from trade or business activities of a partnership (from Schedule K-1 (Form 1065 or 1065-B)). Do not offset ordinary income against ordinary losses. Instead, include the income on line 10. Show the partnership's name, address, and EIN on a separate statement attached to this return. If the amount is from more than one partnership, identify the amount from each partnership.
- Dividends paid in cash on stock held by an employee stock ownership plan. However, a deduction may only be taken if, according to the plan, the dividends are:

1. Paid in cash directly to the plan participants or beneficiaries;
2. Paid to the plan, which distributes them in cash to the plan participants or their beneficiaries no later than 90 days after the end of the plan year in which the dividends are paid; or
3. Used to make payments on a loan described in section 404(a)(9).

See section 404(k) for more details and the limitation on certain dividends.

Also see **Special rules** below for limits on certain other deductions.

#### Do not deduct:

- Fines or penalties paid to a government for violating any law.
- Any amount that is allocable to a class of exempt income. See section 265(b) for exceptions.

**Special rules** apply to the following expenses:

#### Travel, meals, and entertainment.

Subject to limitations and restrictions discussed below, a corporation can deduct ordinary and necessary travel, meals, and entertainment expenses paid or incurred in its trade or business. Also, special rules apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and Pub. 463 for more details.

**Travel.** The corporation cannot deduct travel expenses of any individual accompanying a corporate officer or employee, including a spouse or dependent of the officer or employee, unless:

- That individual is an employee of the corporation and
- His or her travel is for a bona fide business purpose and would otherwise be deductible by that individual.

**Meals and entertainment.** Generally, the corporation can deduct only 50% of the amount otherwise allowable for meals and entertainment expenses paid or incurred in its trade or business. In addition (subject to exceptions under section 274(k)(2)):

- Meals must not be lavish or extravagant;
- A bona fide business discussion must occur during, immediately before, or immediately after the meal; and
- An employee of the corporation must be present at the meal.

See section 274(n)(3) for a special rule that applies to expenses for meals consumed by individuals subject to the hours of service limits of the Department of Transportation.

**Membership dues.** The corporation may deduct amounts paid or incurred for membership dues in civic or public service organizations, professional organizations (such as bar and medical associations), business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards. However, no deduction is allowed if a principal purpose of the organization is to entertain, or provide entertainment facilities for, members or their guests. In addition, corporations may not deduct membership dues in any club organized for business, pleasure, recreation, or other social purpose. This includes country clubs, golf and athletic clubs, airline and hotel clubs, and clubs operated to provide meals under conditions favorable to business discussion.

**Entertainment facilities.** The corporation cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) used for an activity usually considered entertainment, amusement, or recreation.

**Note:** *The corporation may be able to deduct otherwise nondeductible meals, travel, and entertainment expenses if the amounts are treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.*

**Deduction for clean-fuel vehicles and certain refueling property.** Section 179A allows a deduction for part of the cost of qualified clean-fuel vehicle property and qualified clean-fuel vehicle refueling property placed in service during the tax year. For more information, see Pub. 535.

**Lobbying expenses.** Generally, lobbying expenses are not deductible. These expenses include:

- Amounts paid or incurred in connection with influencing Federal or state legislation (but not local legislation) or
- Amounts paid or incurred in connection with any communication with certain Federal executive branch officials in an attempt to influence the official actions or positions of the officials. See Regulations section 1.162-29 for the definition of "influencing legislation."

Dues and other similar amounts paid to certain tax-exempt organizations may not be deductible. See section 162(e)(3). If certain in-house lobbying expenditures do not exceed \$2,000, they are deductible. For information on contributions to charitable organizations that conduct lobbying activities, see the instructions for line 19. For more information on lobbying expenses, see section 162(e).

## Line 28, Form 1120 (Line 24, Form 1120-A)

### Taxable Income Before NOL Deduction and Special Deductions

**At-risk rules.** Generally, special at-risk rules under section 465 apply to closely held corporations (see **Passive activity limitations** on page 9) engaged in any activity as a trade or business or for the production of income. These corporations may have to adjust the amount on line 28, Form 1120, or line 24, Form 1120-A. (See below.)

The at-risk rules do not apply to:

- Holding real property placed in service by the taxpayer before 1987;
- Equipment leasing under sections 465(c)(4), (5), and (6); or
- Any qualifying business of a qualified corporation under section 465(c)(7).

However, the at-risk rules do apply to the holding of mineral property.

If the at-risk rules apply, adjust the amount on this line for any section 465(d) losses. These losses are limited to the amount for which the corporation is at risk for each separate activity at the close of the tax year. If the corporation is involved in one or more activities, any of which incurs a loss for the year, report the losses for each activity separately. Attach **Form 6198**, At-Risk Limitations, showing the amount at

risk and gross income and deductions for the activities with the losses.

If the corporation sells or otherwise disposes of an asset or its interest (either total or partial) in an activity to which the at-risk rules apply, determine the net profit or loss from the activity by combining the gain or loss on the sale or disposition with the profit or loss from the activity. If the corporation has a net loss, it may be limited because of the at-risk rules.

Treat any loss from an activity not allowed for the tax year as a deduction allocable to the activity in the next tax year.

## Line 29a, Form 1120 (Line 25a, Form 1120-A)

### Net Operating Loss Deduction

A corporation may use the net operating loss (NOL) incurred in one tax year to reduce its taxable income in another tax year. Generally, a corporation may carry an NOL back to each of the 2 years preceding the year of the loss and then carry any remaining amount over to each of the 20 years (15 years for NOLs incurred in tax years beginning before August 6, 1997) following the year of the loss (but Form 1120 filers see **Waiving the carryback period** below). For exceptions to the general rule, see **Special carryback periods for certain losses** below.

Enter on line 29a (line 25a, Form 1120-A), the total NOL carryovers from prior tax years, but do not enter more than the corporation's taxable income (after special deductions). An NOL deduction cannot be taken in a year in which the corporation has a negative taxable income. Attach a schedule showing the computation of the NOL deduction. Form 1120 filers must also complete item 12 on Schedule K.

For details on the NOL deduction, see Pub. 542.

**Carryback and carryover rules.** To carry back the loss and obtain a quick refund of taxes, use **Form 1139**, Corporation Application for Tentative Refund. Form 1139 must be filed within 12 months after the close of the tax year of the loss. See section 6411 for details.

For carryback claims filed later than 12 months after the close of the tax year of the loss, file Form 1120X instead of Form 1139.

After the corporation applies the NOL to the first tax year to which it may be carried, the taxable income of that year is modified (as described in section 172(b)) to determine how much of the remaining loss may be carried to other years. See section 172(b) and the related regulations for details.

**Special NOL rules** apply when:

- An ownership change occurs (i.e., the amount of the taxable income of a loss corporation that can be offset by pre-change NOL carryovers is limited). See section 382 and the related regulations. Also see Temporary Regulations section 1.382-2T(a)(2)(ii), which requires that a loss corporation file an information statement with its income tax return for each tax year that it is a loss corporation and certain shifts in ownership occurred. See Regulations section 1.382-6(b) for details on how to make the closing-of-the-books election.

- A corporation acquires control of another corporation (or acquires its assets in a reorganization) and the amount of pre-acquisition losses that may offset recognized built-in gains is limited. See section 384.

**Waiving the carryback period (Form 1120 filers only).** A corporation may make an irrevocable election to waive the carryback period and instead carry the NOL forward to years following the year of the loss. To make this election, check the box in item 11 on Schedule K. To be valid, the election must be made by the due date (including extensions) for filing Form 1120.

**Special carryback periods for certain losses.** The regular 2-year carryback period generally does not apply to the following losses.

- **Specified liability losses**, including a product liability loss. The part of an NOL that is attributable to a specified liability loss may be carried back 10 years. The corporation may, however, elect to treat such a loss as if it were not a specified liability loss. If the corporation makes this election, the loss carryback period will be 2, 3, or 5 years, whichever applies. Make the election by attaching a statement to a timely filed return (including extensions; however, see **Exception** below). Also see section 172(b)(1)(C).

- **Farming losses.** An NOL attributable to any farming business may be carried back 5 years. However, the corporation may elect to treat the loss as if it were not a farming loss. If the corporation makes this election, the loss carryback period will be 2 years or 3 years, whichever applies. Make the election by attaching a statement to a timely filed return (including extensions; however, see **Exception**). Also see sections 172(b)(1)(G) and 172(i).

**Exception.** If the corporation timely filed its return for the loss year without making the election for **Specified liability losses** or **Farming losses** above, the corporation may still make the election by filing an amended return within 6 months of the due date of the loss year return (excluding extensions). Attach the election to the amended return and write "Filed pursuant to section 301.9100-2" on the election statement. File the amended return at the same address the original return was filed. Once made, the election is irrevocable.

- **Eligible losses.** The part of an NOL that is attributable to an eligible loss may be carried back 3 years. An "eligible loss" is an NOL attributable to a Presidentially-declared disaster if, for the tax year in which the NOL arose, the corporation was (a) engaged in a farming business or (b) a small business that met the gross receipts test of section 448(c). An eligible loss does not include any farming loss or specified liability loss described above.

- **Corporate equity reduction interest losses.** See section 172(b)(1)(E) for special rules that apply if the corporation has an NOL attributable to interest deducted in connection with corporate equity reduction transactions.

- **Losses incurred by a personal service corporation (PSC).** A PSC may not carry back an NOL to or from any tax year to which a section 444 election applies.

## Line 29b, Form 1120 (Line 25b, Form 1120-A)

### Special Deductions

**Form 1120 filers.** See the instructions on page 15 for Schedule C.

**Form 1120-A filers.** Generally, enter 70% of line 4, page 1, on line 25b. However, this deduction may not be more than 70% of line 24, page 1. Compute line 24 without regard to any adjustment under section 1059 and without regard to any capital loss carryback to the tax year under section 1212(a)(1).

In a year in which an NOL occurs, this 70% limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

## Line 30, Form 1120 (Line 26, Form 1120-A)

### Taxable Income

**Capital construction fund.** To take a deduction for amounts contributed to a capital construction fund (CCF), reduce the amount that would otherwise be entered on line 30 (line 26, Form 1120-A) by the amount of the deduction. On the dotted line next to the entry space, write "CCF" and the amount of the deduction. For more information, see **Pub. 595**, Tax Highlights for Commercial Fishermen.

## Line 32b, Form 1120 (Line 28b, Form 1120-A)

### Estimated Tax Payments

Enter any estimated tax payments the corporation made for the tax year.

**Beneficiaries of trusts.** If the corporation is the beneficiary of a trust, and the trust makes a section 643(g) election to credit its estimated tax payments to its beneficiaries, include the corporation's share of the payment in the total for line 32b, Form 1120 (line 28b, Form 1120-A). Write "T" and the amount on the dotted line next to the entry space.

**Special estimated tax payments for certain life insurance companies.** If the corporation is required to make or apply special estimated tax payments (SETP) under section 847 in addition to its regular estimated tax payments, enter on line 32b (line 28b, Form 1120-A), the corporation's total estimated tax payments. In the margin near line 32b, write "Form 8816" and the amount. Attach a schedule showing your computation of estimated tax payments. See sections 847(2) and 847(8) and **Form 8816**, Special Loss Discount Account and Special Estimated Tax Payments for Insurance Companies, for more information.

## Line 32f, Form 1120 (Line 28f, Form 1120-A)

Enter the credit (from **Form 2439**, Notice to Shareholder of Undistributed Long-Term Capital Gains) for the corporation's share of the tax paid by a regulated investment company (RIC) or a real estate investment trust (REIT) on undistributed long-term capital gains included in the corporation's income. Attach Form 2439 to Form 1120 or 1120-A.

**Line 32g, Form 1120  
(Line 28g, Form 1120-A)**

**Credit for Federal Tax on Fuels**

Complete and attach **Form 4136**, Credit for Federal Tax Paid on Fuels, if the corporation qualifies to take this credit.

**Credit for tax on ozone-depleting chemicals.** Include on line 32g (line 28g, Form 1120-A) any credit the corporation is claiming under section 4682(g)(2) for tax on ozone-depleting chemicals. Write "ODC" to the left of the entry space.

**Line 32h, Form 1120  
(Line 28h, Form 1120-A)**

**Total Payments**

On Form 1120, add the amounts on lines 32d through 32g and enter the total on line 32h. On Form 1120-A, add the amounts on lines 28d through 28g and enter the total on line 28h.

**Backup withholding.** If the corporation had income tax withheld from any payments it received because, for example, it failed to give the payer its correct EIN, include the amount withheld in the total for line 32h, Form 1120 (line 28h, Form 1120-A). This type of withholding is called backup withholding. On Form 1120, show the amount withheld in the blank space in the right-hand column between lines 31 and 32h, and write "Backup Withholding." On Form 1120-A, show the amount withheld on the dotted line to the left of line 28h, and write "Backup Withholding."

**Line 33, Form 1120  
(Line 29, Form 1120-A)**

**Estimated Tax Penalty**

A corporation that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a corporation is subject to the penalty if its tax liability is \$500 or more and it did not timely pay the smaller of:

- Its tax liability for 2001 or
- Its prior year's tax.

See section 6655 for details and exceptions, including special rules for large corporations.

Use **Form 2220**, Underpayment of Estimated Tax by Corporations, to see if the corporation owes a penalty and to figure the amount of the penalty. Generally, the corporation does not have to file this form because the IRS can figure the amount of any penalty and bill the corporation for it. However, even if the corporation does not owe the penalty, complete and attach Form 2220 if:

- The annualized income or adjusted seasonal installment method is used or
- The corporation is a large corporation computing its first required installment based on the prior year's tax. (See the Instructions for Form 2220 for the definition of a large corporation.)

If Form 2220 is attached, check the box on line 33, Form 1120 (line 29, Form 1120-A), and enter the amount of any penalty on this line.

**Line 36, Form 1120  
(Line 32, Form 1120-A)**

**Direct Deposit of Refund**

If the corporation wants its refund directly deposited into its checking or savings account at any U.S. bank or other financial institution instead of having a check sent to the corporation, complete Form 8050 and attach it to the corporation's tax return.

**Schedule A, Form 1120  
(Worksheet, Form 1120-A)**

**Cost of Goods Sold**

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1.

However, if the corporation is a qualifying taxpayer, it may adopt or change its accounting method to account for inventoriable items in the same manner as materials and supplies that are not incidental. A **qualifying taxpayer** is a taxpayer (a) whose average annual gross receipts for the 3 prior tax years is \$1 million or less and (b) whose business is not a tax shelter (as defined in section 448(d)(3)). In addition, for tax years ending on or after December 31, 2001, this rule applies to an eligible business of a qualifying small

business taxpayer. A **qualifying small business taxpayer** includes a corporation with average annual gross receipts of more than \$1 million but less than or equal to \$10 million and that is not prohibited from using the cash method under section 448. For more details, including the definition of an eligible business, see Notice 2001-76.

Under this accounting method, inventory costs for raw materials purchased for use in producing finished goods and merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (but not before the year the corporation paid for the raw materials or merchandise, if it is also using the cash method). Enter amounts paid for all raw materials and merchandise during the tax year on line 2. The amount the corporation can deduct for the tax year is figured on line 8. For additional guidance on this method of accounting for inventory items, see Rev. Proc. 2001-10 and Pub. 538.

All filers not using the cash method of accounting should see **Section 263A uniform capitalization rules** on page 9 before completing Schedule A or the worksheet. The instructions for lines 4 through 7 below apply to Schedule A and the worksheet below.

**Line 1**

**Inventory at Beginning of Year**

If the corporation is changing its method of accounting for the current tax year, it must refigure last year's closing inventory using its new method of accounting and enter the result on line 1. If there is a difference between last year's closing inventory and the refigured amount, attach an explanation and take it into account when figuring the corporation's section 481(a) adjustment (explained on page 6).

**Line 4**

**Additional Section 263A Costs**

An entry is required on this line only for corporations that have elected a simplified method of accounting.

For corporations that have elected the **simplified production method**, additional section 263A costs are generally those costs, other than interest, that were not capitalized under the corporation's method of accounting immediately prior to the effective date of section 263A but are now required to be capitalized under section 263A. For details, see Regulations section 1.263A-2(b).

For corporations that have elected the **simplified resale method**, additional section 263A costs are generally those costs incurred with respect to the following categories.

- Off-site storage or warehousing.
- Purchasing; handling, such as processing, assembling, repackaging, and transporting.
- General and administrative costs (mixed service costs).

For details, see Regulations section 1.263A-3(d).

Enter on line 4 the balance of section 263A costs paid or incurred during the tax year not includible on lines 2, 3, and 5.

**Cost of Goods Sold Worksheet**

**Form 1120-A**  
(keep for your records)

1. Inventory at start of year. Enter here and in Part III, line 3, column (a), Form 1120-A. . . . .	1. _____
2. Purchases. Enter here and in Part II, line 5a(1), Form 1120-A . . . . .	2. _____
3. Cost of labor. Enter here and include in total in Part II, line 5a(3), Form 1120-A . . . . .	3. _____
4. Additional section 263A costs. Enter here and in Part II, line 5a(2), Form 1120-A (see instructions for line 4). . . . .	4. _____
5. Other costs. Enter here and include in Part II, line 5a(3), Form 1120-A . . . . .	5. _____
6. Total. Add lines 1 through 5 . . . . .	6. _____
7. Inventory at end of year. Enter here and in Part III, line 3, column (b), Form 1120-A. . . . .	7. _____
8. <b>Cost of goods sold.</b> Subtract line 7 from line 6. Enter the result here and on page 1, line 2, Form 1120-A . . . . .	8. _____

**Line 5**

**Other Costs**

Enter on line 5 any costs paid or incurred during the tax year not entered on lines 2 through 4.

**Line 7**

**Inventory at End of Year**

See Regulations section 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory.

If the corporation accounts for inventoriable items in the same manner as materials and supplies that are not incidental, enter on line 7 the portion of its raw materials and merchandise purchased for resale that are included on line 6 and were not sold during the year.

**Lines 9a through 9f (Schedule A)**

**Inventory Valuation Methods**

Inventories can be valued at:

- Cost;
- Cost or market value (whichever is lower); or
- Any other method approved by the IRS that conforms to the requirements of the applicable regulations cited below.

However, if the corporation is using the cash method of accounting, it is required to use cost.

Corporations that account for inventoriable items in the same manner as materials and supplies that are not incidental may currently deduct expenditures for direct labor and all indirect costs that would otherwise be included in inventory costs.

The average cost (rolling average) method of valuing inventories generally does not conform to the requirements of the regulations. See Rev. Rul. 71-234, 1971-1 C.B. 148.

Corporations that use erroneous valuation methods must change to a method permitted for Federal income tax purposes. To make this change, use Form 3115.

On line 9a, check the method(s) used for valuing inventories. Under lower of cost or market, the term "market" (for normal goods) means the current bid price prevailing on the inventory valuation date for the particular merchandise in the volume usually purchased by the taxpayer. For a manufacturer, market applies to the basic elements of cost—raw materials, labor, and burden. If section 263A applies to the taxpayer, the basic elements of cost must reflect the current bid price of all direct costs and all indirect costs properly allocable to goods on hand at the inventory date.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are subnormal due to damage, imperfections, shopwear, etc., within the meaning of Regulations section 1.471-2(c). The goods may be valued at the current bona fide selling price, minus direct cost of disposition (but not less than scrap value) if such a price can be established.

If this is the first year the Last-in, First-out (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method provided in section 472, attach **Form 970, Application To Use LIFO Inventory Method**, or a statement with the information required by Form 970. Also check the LIFO box on line 9c. On line 9d, enter the amount or the percent of total closing inventories covered under section 472. Estimates are acceptable.

If the corporation changed or extended its inventory method to LIFO and had to write up the opening inventory to cost in the year of election, report the effect of the write-up as other income (line 10, page 1), proportionately over a 3-year period that begins with the year of the LIFO election (section 472(d)).

**Note:** *Corporations using the LIFO method that make an S corporation election or*

*transfer LIFO inventory to an S corporation in a nonrecognition transaction may be subject to an additional tax attributable to the LIFO recapture amount. See the instructions for line 11, Schedule J, on page 19, and for line 10, Other Income, beginning on page 8.*

For more information on inventory valuation methods, see Pub. 538.

**Schedule C (Form 1120 Only)**

**Dividends and Special Deductions**

For purposes of the 20% ownership test on lines 1 through 7, the percentage of stock owned by the corporation is based on voting power and value of the stock. Preferred stock described in section 1504(a)(4) is not taken into account. Corporations filing a consolidated return should see Regulations sections 1.1502-13, 1.1502-26, and 1.1502-27 before completing Schedule C.

**Line 1, Column (a)**

Enter dividends (except those received on debt-financed stock acquired after July 18, 1984—see section 246A) that:

- Are received from less-than-20%-owned domestic corporations subject to income tax and
- Qualify for the 70% deduction under section 243(a)(1).

Also include on line 1:

- Taxable distributions from an IC-DISC or former DISC that are designated as eligible for the 70% deduction and certain dividends of Federal Home Loan Banks. See section 246(a)(2).
- Dividends (except those received on debt-financed stock acquired after July 18, 1984) from a regulated investment company (RIC). The amount of dividends eligible for the dividends-received deduction under section 243 is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

Report so-called dividends or earnings received from mutual savings banks, etc., as interest. Do not treat them as dividends.

**Worksheet for Schedule C, line 9**

(keep for your records)

1. Refigure line 28, page 1, Form 1120, without any adjustment under section 1059 and without any capital loss carryback to the tax year under section 1212(a)(1)	1. _____
2. Complete lines 10, 11, and 12, column (c), and enter the total here	2. _____
3. Subtract line 2 from line 1	3. _____
4. Multiply line 3 by 80%	4. _____
5. Add lines 2, 5, 7, and 8, column (c), and the part of the deduction on line 3, column (c), that is attributable to dividends from 20%-or-more-owned corporations	5. _____
6. Enter the smaller of line 4 or 5. If line 5 is greater than line 4, stop here; enter the amount from line 6 on line 9, column (c), and do not complete the rest of this worksheet	6. _____
7. Enter the total amount of dividends from 20%-or-more-owned corporations that are included on lines 2, 3, 5, 7, and 8, column (a)	7. _____
8. Subtract line 7 from line 3	8. _____
9. Multiply line 8 by 70%	9. _____
10. Subtract line 5 above from line 9, column (c).	10. _____
11. Enter the smaller of line 9 or line 10	11. _____
12. <b>Dividends-received deduction after limitation</b> (sec. 246(b)). Add lines 6 and 11. Enter the result here and on line 9, column (c)	12. _____

**Line 2, Column (a)**

Enter on line 2:

- Dividends (except those received on debt-financed stock acquired after July 18, 1984) that are received from 20%-or-more-owned domestic corporations subject to income tax and that are subject to the 80% deduction under section 243(c) and
- Taxable distributions from an IC-DISC or former DISC that are considered eligible for the 80% deduction.

**Line 3, Column (a)**

Enter dividends that are:

- Received on debt-financed stock acquired after July 18, 1984, from domestic and foreign corporations subject to income tax that would otherwise be subject to the dividends-received deduction under section 243(a)(1), 243(c), or 245(a). Generally, debt-financed stock is stock that the corporation acquired by incurring a debt (e.g., it borrowed money to buy the stock).

- Received from a RIC on debt-financed stock. The amount of dividends eligible for the dividends-received deduction is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

### Line 3, Columns (b) and (c)

Dividends received on debt-financed stock acquired after July 18, 1984, are not entitled to the full 70% or 80% dividends-received deduction. The 70% or 80% deduction is reduced by a percentage that is related to the amount of debt incurred to acquire the stock. See section 246A. Also, see section 245(a) before making this computation for an additional limitation that applies to dividends received from foreign corporations. Attach a schedule to Form 1120 showing how the amount on line 3, column (c), was figured.

### Line 4, Column (a)

Enter dividends received on the preferred stock of a less-than-20%-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

### Line 5, Column (a)

Enter dividends received on preferred stock of a 20%-or-more-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

### Line 6, Column (a)

Enter the U.S.–source portion of dividends that:

- Are received from less-than-20%-owned foreign corporations and
- Qualify for the 70% deduction under section 245(a). To qualify for the 70% deduction, the corporation must own at least 10% of the stock of the foreign corporation by vote and value.

Also include dividends received from a less-than-20%-owned FSC that:

- Are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and
- Qualify for the 70% deduction provided in section 245(c)(1)(B).

### Line 7, Column (a)

Enter the U.S.–source portion of dividends that are received from 20%-or-more-owned foreign corporations that qualify for the 80% deduction under section 245(a). Also include dividends received from a 20%-or-more-owned FSC that:

- Are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and
- Qualify for the 80% deduction provided in section 245(c)(1)(B).

### Line 8, Column (a)

Enter dividends received from wholly owned foreign subsidiaries that are eligible for the 100% deduction provided in section 245(b).

In general, the deduction under section 245(b) applies to dividends paid out of the earnings and profits of a foreign corporation for a tax year during which:

- All of its outstanding stock is owned (directly or indirectly) by the domestic corporation receiving the dividends and
- All of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

### Line 9, Column (c)

#### Limitation on Dividends-Received Deduction

Generally, line 9, column (c), may not exceed the amount from the worksheet on page 15. However, in a year in which an NOL occurs, this limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

### Line 10, Columns (a) and (c)

Small business investment companies operating under the Small Business Investment Act of 1958 (15 U.S.C. 661 and following) must enter dividends that are received from domestic corporations subject to income tax even though a deduction is allowed for the entire amount of those dividends. To claim the 100% deduction on line 10, column (c), the company must file with its return a statement that it was a Federal licensee under the Small Business Investment Act of 1958 at the time it received the dividends.

### Line 11, Column (a)

Enter dividends from FSCs that are attributable to foreign trade income and that are eligible for the 100% deduction provided in section 245(c)(1)(A).

### Line 12, Columns (a) and (c)

Enter only those dividends that qualify under section 243(b) for the 100% dividends-received deduction described in section 243(a)(3). Corporations taking this deduction are subject to the provisions of section 1561.

The 100% deduction does not apply to affiliated group members that are joining in the filing of a consolidated return.

### Line 13, Column (a)

Enter foreign dividends not reportable on lines 3, 6, 7, 8, or 11 of column (a). Include on line 13 the corporation's share of the ordinary earnings of a qualified electing fund from Form 8621, line 1c. Exclude distributions of amounts constructively taxed in the current year or in prior years under subpart F (sections 951 through 964).

### Line 14, Column (a)

Include income constructively received from controlled foreign corporations under subpart F. This amount should equal the total subpart F income reported on Schedule I, Form 5471.

### Line 15, Column (a)

Include gross-up for taxes deemed paid under sections 902 and 960.

### Line 16, Column (a)

Enter taxable distributions from an IC-DISC or former DISC that are designated as not eligible for a dividends-received deduction.

No deduction is allowed under section 243 for a dividend from an IC-DISC or

former DISC (as defined in section 992(a)) to the extent the dividend:

- Is paid out of the corporation's accumulated IC-DISC income or previously taxed income or
- Is a deemed distribution under section 995(b)(1).

### Line 17, Column (a)

Include the following:

1. Dividends (other than capital gain distributions reported on Schedule D (Form 1120) and exempt-interest dividends) that are received from RICs and that are not subject to the 70% deduction.

2. Dividends from tax-exempt organizations.

3. Dividends (other than capital gain distributions) received from a REIT that, for the tax year of the trust in which the dividends are paid, qualifies under sections 856 through 860.

4. Dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments with respect to similar stock.

Two situations in which the dividends-received deduction will not be allowed on any share of stock are:

- If the corporation held it less than 46 days during the 90-day period beginning 45 days before the stock became ex-dividend with respect to the dividend (see section 246(c)(1)(A)) or

- To the extent the corporation is under an obligation to make related payments for substantially similar or related property.

5. Any other taxable dividend income not properly reported above (including distributions under section 936(h)(4)).

If patronage dividends or per-unit retain allocations are included on line 17, identify the total of these amounts in a schedule attached to Form 1120.

### Line 18, Column (c)

Section 247 allows public utilities a deduction of 40% of the smaller of:

- Dividends paid on their preferred stock during the tax year or
- Taxable income computed without regard to this deduction.

In a year in which an NOL occurs, compute the deduction without regard to section 247(a)(1)(B). See section 172(d).

## Schedule J, Form 1120 (Part I, Form 1120-A)

### Tax Computation

#### Lines 1 and 2, Form 1120

**Members of a controlled group (Form 1120 only).** A member of a controlled group, as defined in section 1563, must check the box on line 1 and complete lines 2a and 2b of Schedule J, Form 1120.

**Line 2a.** Members of a controlled group are entitled to one \$50,000, one \$25,000, and one \$9,925,000 taxable income bracket amount (in that order) on line 2a.

When a controlled group adopts or later amends an apportionment plan, each member must attach to its tax return a copy of its consent to this plan. The copy (or an

attached statement) must show the part of the amount in each taxable income bracket apportioned to that member. See Regulations section 1.1561-3(b) for other requirements and for the time and manner of making the consent.

**Unequal apportionment plan.**

Members of a controlled group may elect an unequal apportionment plan and divide the taxable income brackets as they want. There is no need for consistency among taxable income brackets. Any member may be entitled to all, some, or none of the taxable income bracket. However, the total amount for all members cannot be more than the total amount in each taxable income bracket.

**Equal apportionment plan.** If no apportionment plan is adopted, members of a controlled group must divide the amount in each taxable income bracket equally among themselves. For example, Controlled Group AB consists of Corporation A and Corporation B. They do not elect an apportionment plan. Therefore, each corporation is entitled to:

- \$25,000 (one-half of \$50,000) on line 2a(1),
- \$12,500 (one-half of \$25,000) on line 2a(2), and
- \$4,962,500 (one-half of \$9,925,000) on line 2a(3).

**Line 2b.** Members of a controlled group are treated as one group to figure the applicability of the additional 5% tax and the additional 3% tax. If an additional tax applies, each member will pay that tax based on the part of the amount used in each taxable income bracket to reduce that member's tax. See section 1561(a). If an additional tax applies, attach a schedule showing the taxable income of the entire group and how the corporation figured its share of the additional tax.

**Line 2b(1).** Enter the corporation's share of the additional 5% tax on line 2b(1).

**Line 2b(2).** Enter the corporation's share of the additional 3% tax on line 2b(2).

**Line 3, Form 1120 (Line 1, Form 1120-A)**

Members of a controlled group should use the worksheet above to figure the tax for the group. In addition, members of a controlled group **must** attach to Form 1120 a statement showing the computation of the tax entered on line 3.

Most corporations not filing a consolidated return figure their tax by using the Tax Rate Schedule below. Qualified personal service corporations should see the instructions below.

**Tax Computation Worksheet for Members of a Controlled Group**  
(keep for your records)

**Note:** Each member of a controlled group (except a qualified personal service corporation) must compute the tax using this worksheet.

1. Enter taxable income (line 30, page 1, Form 1120) . . . . . 1. \_\_\_\_\_
2. Enter line 1 or the corporation's share of the \$50,000 taxable income bracket, whichever is less . . . . . 2. \_\_\_\_\_
3. Subtract line 2 from line 1 . . . . . 3. \_\_\_\_\_
4. Enter line 3 or the corporation's share of the \$25,000 taxable income bracket, whichever is less . . . . . 4. \_\_\_\_\_
5. Subtract line 4 from line 3 . . . . . 5. \_\_\_\_\_
6. Enter line 5 or the corporation's share of the \$9,925,000 taxable income bracket, whichever is less . . . . . 6. \_\_\_\_\_
7. Subtract line 6 from line 5 . . . . . 7. \_\_\_\_\_
8. Multiply line 2 by 15% . . . . . 8. \_\_\_\_\_
9. Multiply line 4 by 25% . . . . . 9. \_\_\_\_\_
10. Multiply line 6 by 34% . . . . . 10. \_\_\_\_\_
11. Multiply line 7 by 35% . . . . . 11. \_\_\_\_\_
12. If the taxable income of the controlled group exceeds \$100,000, enter this member's share of the smaller of: 5% of the taxable income in excess of \$100,000, or \$11,750 (See the instructions for Schedule J, line 2b.) . . . . . 12. \_\_\_\_\_
13. If the taxable income of the controlled group exceeds \$15 million, enter this member's share of the smaller of: 3% of the taxable income in excess of \$15 million, or \$100,000 (See the instructions for Schedule J, line 2b.) . . . . . 13. \_\_\_\_\_
14. **Total.** Add lines 8 through 13. Enter here and on line 3, Schedule J, Form 1120 . . . . . 14. \_\_\_\_\_

**Tax Rate Schedule**

If taxable income (line 30, Form 1120, or line 26, Form 1120-A) on page 1 is:

Over—	But not over—	Tax is:	Of the amount over—
\$0	\$50,000	15%	\$0
50,000	75,000	\$ 7,500 + 25%	50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	10,000,000	113,900 + 34%	335,000
10,000,000	15,000,000	3,400,000 + 35%	10,000,000
15,000,000	18,333,333	5,150,000 + 38%	15,000,000
18,333,333	-----	35%	0

**Qualified personal service corporation.** A qualified personal service corporation is taxed at a flat rate of 35% on taxable income. If the corporation is a qualified personal service corporation, check the box on line 3, Schedule J, Form 1120 (or line 1, Part I, Form 1120-A) even if the corporation has no tax liability.

A corporation is a qualified personal service corporation if it meets **both** of the following tests:

- Substantially all of the corporation's activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting and
- At least 95% of the corporation's stock, by value, is owned, directly or indirectly, by (a) employees performing the services, (b) retired employees who had performed the services listed above, (c) any estate of the employee or retiree described above, or (d) any person who acquired the stock of the corporation as a result of the death of an employee or retiree (but only for the 2-year period beginning on the date of the

employee or retiree's death). See Temporary Regulations section 1.448-1T(e) for details.

**Mutual savings bank conducting life insurance business.** The tax under section 594 consists of the sum of (a) a partial tax computed on Form 1120 on the taxable income of the bank determined without regard to income or deductions allocable to the life insurance department and (b) a partial tax on the taxable income computed on Form 1120-L of the life insurance department. Enter the combined tax on line 3 of Schedule J, Form 1120. Attach Form 1120-L as a schedule and identify it as such.

**Deferred tax under section 1291.** If the corporation was a shareholder in a passive foreign investment company (PFIC) and received an excess distribution or disposed of its investment in the PFIC during the year, it must include the increase in taxes due under section 1291(c)(2) in the total for line 3, Schedule J, Form 1120. On the dotted line next to line 3, write "Section 1291" and the amount.

Do not include on line 3 any interest due under section 1291(c)(3). Instead, show the amount of interest owed in the bottom margin of page 1, Form 1120, and write "Section 1291 interest." For details, see **Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.

**Additional tax under section 197(f).** A corporation that elects to pay tax on the gain from the sale of an intangible under the related person exception to the anti-churning rules should include any additional tax due under section 197(f)(9)(B) in the total for line 3. On the dotted line next to line 3, write "Section 197" and the amount. For more information, see **Pub. 535**, Business Expenses.

## Line 4, Form 1120 (Line 2, Form 1120-A)

### Alternative Minimum Tax

Unless the corporation is treated as a small corporation exempt from the alternative minimum tax (AMT), it may owe the AMT if it has any of the adjustments and tax preference items listed on **Form 4626**, Alternative Minimum Tax—Corporations. The corporation must file Form 4626 if its taxable income (loss) combined with these adjustments and tax preference items is more than the smaller of \$40,000 or the corporation's allowable exemption amount (from Form 4626).

For this purpose, taxable income does not include the NOL deduction. See Form 4626 for details.

**Exemption for small corporations.** A corporation is treated as a small corporation exempt from the AMT for its tax year beginning in 2001 if that year is the corporation's first tax year in existence (regardless of its gross receipts) or:

1. It was treated as a small corporation exempt from the AMT for all prior tax years beginning after 1997 **and**
2. Its average annual gross receipts for the 3-tax-year period (or portion thereof during which the corporation was in existence) ending before its tax year beginning in 2001 did not exceed \$7.5 million (\$5 million if the corporation had only 1 prior tax year).

## Line 6a (Form 1120 Only)

### Foreign Tax Credit

To find out when a corporation can take the credit for payment of income tax to a foreign country or U.S. possession, see **Form 1118**, Foreign Tax Credit—Corporations.

## Line 6b (Form 1120 Only)

### Possessions Tax Credit

The Small Business Job Protection Act of 1996 repealed the possessions credit. However, existing credit claimants may qualify for a credit under the transitional rules. See **Form 5735**, Possessions Corporation Tax Credit (Under Sections 936 and 30A).

## Line 6c (Form 1120 Only)

If the corporation can take either of the following credits, check the appropriate box(es) and include the amount of the credits in the total for line 6c.

**Nonconventional source fuel credit.** A credit is allowed for the sale of qualified fuels produced from a nonconventional source. Section 29 contains a definition of qualified fuels, provisions for figuring the credit, and other special rules. Attach a separate schedule to the return showing the computation of the credit.

**Qualified electric vehicle (QEV) credit.** Use **Form 8834**, Qualified Electric Vehicle Credit, if the corporation can claim a credit for the purchase of a new qualified electric vehicle. Vehicles that qualify for this credit are not eligible for the deduction for clean-fuel vehicles under section 179A.

## Line 6d, Form 1120 (Line 4a, Form 1120-A)

### General Business Credit

Check the "Form 3800" box, complete **Form 3800**, General Business Credit, and enter the total of the credit(s) on line 6d (line 4a, Form 1120-A) if the corporation has any of the following:

- More than one of the general business credits listed below (other than the empowerment zone employment credit),
- General credits from an electing large partnership shown in box 7 of Schedule K-1 (Form 1065-B),
- A credit carryforward or carryback of any of these credits (other than the empowerment zone employment credit),
- A trans-Alaska pipeline liability fund credit, or
- Any of these credits (other than the low-income housing credit and the empowerment zone employment credit) that is from a passive activity.

**Note:** A corporation filing **Form 3800** and **Form 8844**, Empowerment Zone Employment Credit, would check **both** the "Form 3800" box and the "Form(s)" box, write "8844" in the space provided, and enter the total of the credits on line 6d (line 4a, Form 1120-A).

If the corporation is not required to file Form 3800, attach the applicable form(s) listed in parentheses below. Check the "Form(s)" box, write the attached form number(s) in the space provided, and include the total of the credit(s) on line 6d (line 4a, Form 1120-A).

- Investment Credit (Form 3468).
- Work Opportunity Credit (Form 5884).
- Credit for Alcohol Used as Fuel (Form 6478).
- Credit for Increasing Research Activities (Form 6765).
- Low-Income Housing Credit (Form 8586).
- Orphan Drug Credit (Form 8820).
- Disabled Access Credit (Form 8826).
- Enhanced Oil Recovery Credit (Form 8830).
- Renewable Electricity Production Credit (Form 8835).
- Empowerment Zone Employment Credit (Form 8844). While the empowerment zone employment credit is a part of the general business credit, it is figured separately on Form 8844 and never carried to Form 3800.
- Indian Employment Credit (Form 8845).
- Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips (Form 8846).
- Credit for Contributions to Selected Community Development Corporations (Form 8847).
- Welfare-to-Work Credit (Form 8861).
- New Markets Credit (Form 8874).

## Line 6e, Form 1120 (Line 4b, Form 1120-A)

### Credit for Prior Year Minimum Tax

To figure the minimum tax credit and any carryforward of that credit, use **Form 8827**, Credit for Prior Year Minimum Tax—Corporations. Also see Form 8827 if any of the corporation's 2000 nonconventional

source fuel credit or qualified electric vehicle credit was disallowed solely because of the tentative minimum tax limitation. See section 53(d).

## Line 6f (Form 1120 Only)

Enter the amount of any credit from **Form 8860**, Qualified Zone Academy Bond Credit.

## Line 9 (Form 1120 Only)

### Personal Holding Company Tax

A corporation is taxed as a personal holding company under section 542 if:

- At least 60% of its adjusted ordinary gross income for the tax year is personal holding company income and
- At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by five or fewer individuals.

See Schedule PH (Form 1120) for definitions and details on how to figure the tax.

## Line 10, Form 1120 (Line 7, Form 1120-A)

### Other Taxes

Include any of the following taxes and interest in the total on line 10 (line 7, Form 1120-A). Check the appropriate box(es) for the form, if any, used to compute the total.

**Recapture of investment credit.** If the corporation disposed of investment credit property or changed its use before the end of its useful life or recovery period, it may owe a tax. See **Form 4255**, Recapture of Investment Credit, for details.

**Recapture of low-income housing credit.** If the corporation disposed of property (or there was a reduction in the qualified basis of the property) for which it took the low-income housing credit, it may owe a tax. See **Form 8611**, Recapture of Low-Income Housing Credit.

**Interest due under the look-back methods.** If the corporation used the look-back method for certain long-term contracts, see Form 8697 for information on figuring the interest the corporation may have to include.

The corporation may also have to include interest due under the look-back method for property depreciated under the income forecast method. See Form 8866.

**Other.** Additional taxes and interest amounts may be included in the total entered on line 10 (line 7, Part I, Form 1120-A). Check the box for "Other" if the corporation includes any of the taxes and interest discussed below. See **How to report**, on page 19, for details on reporting these amounts on an attached schedule.

- Recapture of qualified electric vehicle (QEV) credit. The corporation must recapture part of the QEV credit it claimed in a prior year if, within 3 years of the date the vehicle was placed in service, it ceases to qualify for the credit. See Regulations section 1.30-1 for details on how to figure the recapture.

- Recapture of Indian employment credit. Generally, if an employer terminates the employment of a qualified employee less than 1 year after the date of initial employment, any Indian employment credit

allowed for a prior tax year because of wages paid or incurred to that employee must be recaptured. For details, see Form 8845 and section 45A.

- Tax and interest on a nonqualified withdrawal from a capital construction fund (section 7518).
- Interest on deferred tax attributable to (a) installment sales of certain timeshares and residential lots (section 453(l)(3)) and (b) certain nondealer installment obligations (section 453A(c)).
- Interest due on deferred gain (section 1260(b)).

**How to report.** If the corporation checked the "Other" box, attach a schedule showing the computation of each item included in the total for line 10 (line 7, Part I, Form 1120-A) and identify the applicable Code section and the type of tax or interest.

## Line 11 ( Form 1120 Only)

### Total Tax

**Include** any deferred tax on the termination of a section 1294 election applicable to shareholders in a qualified electing fund in the amount entered on line 11. See Form 8621, Part V, and **How to report**, below.

**Subtract** the following amounts from the total for line 11.

- Deferred tax on the corporation's share of undistributed earnings of a qualified electing fund (see Form 8621, Part II).
- Deferred LIFO recapture tax (section 1363(d)). This tax is the part of the LIFO recapture tax that will be deferred and paid with Form 1120S in the future. To figure the deferred tax, first figure the total LIFO recapture tax. Follow the steps below to figure the total LIFO recapture tax and the deferred amount. Also see the instructions regarding LIFO recapture amount under **Line 10, Other Income**, beginning on page 8.

**Step 1.** Figure the tax on the corporation's income including the LIFO recapture amount. (Complete Schedule J through line 10, but do not enter a total on line 11 yet.)

**Step 2.** Using a separate worksheet, complete Schedule J again, but **do not** include the LIFO recapture amount in the corporation's taxable income.

**Step 3.** Compare the tax in Step 2 to the tax in Step 1. (The difference between the two is the **LIFO recapture tax**.)

**Step 4.** Multiply the amount figured in Step 3 by 75%. (The result is the **deferred LIFO recapture tax**.)

**How to report.** Attach a schedule showing the computation of each item included in, or subtracted from, the total for line 11. On the dotted line next to line 11, specify (a) the applicable Code section, (b) the type of tax, and (c) enter the amount of tax. For example, if the corporation is deferring \$100 LIFO recapture tax, subtract this amount from the total on line 11, then enter "Section 1363-Deferred Tax-\$100" on the dotted line next to line 11.

## Schedule K, Form 1120 (Part II, Form 1120-A)

### Other Information

The following instructions apply to Form 1120, page 3, Schedule K, or Form 1120-A, page 2, Part II. Be sure to complete all the items that apply to the corporation.

### Question 4 (Form 1120 Only)

Check the "Yes" box for question 4 if:

- The corporation is a subsidiary in an affiliated group (defined below), but is not filing a consolidated return for the tax year with that group or
- The corporation is a subsidiary in a parent-subsidiary controlled group (defined below).

Any corporation that meets either of the requirements above should check the "Yes" box. This applies even if the corporation is a subsidiary member of one group and the parent corporation of another.

**Note:** *If the corporation is an "excluded member" of a controlled group (see section 1563(b)(2)), it is still considered a member of a controlled group for this purpose.*

**Affiliated group.** The term "affiliated group" means one or more chains of includible corporations (section 1504(a)) connected through stock ownership with a common parent corporation. The common parent must be an includible corporation and the following requirements **must** be met:

1. The common parent must own directly stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of at least one of the other includible corporations and
2. Stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of each of the other corporations (except for the common parent) must be owned directly by one or more of the other includible corporations.

For this purpose, the term "stock" generally does not include any stock that (a) is nonvoting, (b) is nonconvertible, (c) is limited and preferred as to dividends and does not participate significantly in corporate growth, and (d) has redemption and liquidation rights that do not exceed the issue price of the stock (except for a reasonable redemption or liquidation premium). See section 1504(a)(4).

**Parent-subsidiary controlled group.** The term "parent-subsidiary controlled group" means one or more chains of corporations connected through stock ownership (section 1563(a)(1)). Both of the following requirements **must** be met:

1. At least 80% of the total combined voting power of all classes of voting stock, or at least 80% of the total value of all classes of stock of each corporation in the group (except the parent) must be owned by one or more of the other corporations in the group and
2. The common parent must own at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of one or more of the other corporations in the group. Stock owned directly by other members of the group is

not counted when computing the voting power or value.

See section 1563(d)(1) for the definition of "stock" for purposes of determining stock ownership above.

### Question 6 (Form 1120-A Only)

**Foreign financial accounts.** Check the "Yes" box for question 6 if either 1 or 2 below applies to the corporation. Otherwise, check the "No" box:

1. At any time during the 2001 calendar year, the corporation had an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country (see **Form TD F 90-22.1**, Report of Foreign Bank and Financial Accounts); and
  - The combined value of the accounts was more than \$10,000 at any time during the calendar year and
  - The account was **not** with a U.S. military banking facility operated by a U.S. financial institution.

2. The corporation owns more than 50% of the stock in any corporation that would answer "Yes" to item 1 above.

If the "Yes" box is checked for the question:

- Enter the name of the foreign country or countries. Attach a separate sheet if more space is needed.
- File Form TD F 90-22.1 by June 30, 2002, with the Department of the Treasury at the address shown on the form. Because Form TD F 90-22.1 is not a tax form, do not file it with Form 1120-A. You can order Form TD F 90-22.1 by calling 1-800-TAX-FORM (1-800-829-3676) or you can download it from the IRS Web Site at **www.irs.gov**.

### Question 7 (Form 1120 Only)

Check the "Yes" box if one foreign person owned at least 25% of (a) the total voting power of all classes of stock of the corporation entitled to vote or (b) the total value of all classes of stock of the corporation.

The constructive ownership rules of section 318 apply in determining if a corporation is foreign owned. See section 6038A(c)(5) and the related regulations.

Enter on line 7a the percentage owned by the foreign person specified in question 7. On line 7b, write the name of the owner's country.

**Note:** *If there is more than one 25%-or-more foreign owner, complete lines 7a and 7b for the foreign person with the highest percentage of ownership.*

**Foreign person.** The term "foreign person" means:

- A foreign citizen or nonresident alien.
- An individual who is a citizen of a U.S. possession (but who is not a U.S. citizen or resident).
- A foreign partnership.
- A foreign corporation.
- Any foreign estate or trust within the meaning of section 7701(a)(31).
- A foreign government (or one of its agencies or instrumentalities) to the extent that it is engaged in the conduct of a commercial activity as described in section 892.

**Owner's country.** For individuals, the term "owner's country" means the country of residence. For all others, it is the country where incorporated, organized, created, or administered.

**Requirement to file Form 5472.** If the corporation checked "Yes," it may have to file Form 5472. Generally, a 25% foreign-owned corporation that had a reportable transaction with a foreign or domestic related party during the tax year must file Form 5472.

See Form 5472 for filing instructions and penalties for failure to file.

### Item 9, Form 1120 (Item 3, Form 1120-A)

Show any **tax-exempt interest** received or accrued. Include any exempt-interest dividends received as a shareholder in a mutual fund or other RIC.

### Item 11 (Form 1120 Only)

Check the box if the corporation elects under section 172(b)(3) to forego the carryback period for a **net operating loss (NOL)**. To be valid, the election must be made by the due date (including extensions of time) for filing Form 1120. If the corporation checks this box, do not attach the statement described in Temporary Regulations section 301.9100-12T(d).

Corporations filing a **consolidated return** must check the box and attach the statement required by Regulations section 1.1502-21(b)(3)(i) or (ii).

### Item 12 (Form 1120 Only)

Enter the amount of the **net operating loss (NOL)** carryover to the tax year from prior years, even if some of the loss is used to offset income on this return. The amount to enter is the total of all NOLs generated in prior years but not used to offset income (either as a carryback or carryover) to a tax year prior to 2001. Do not reduce the amount by any NOL deduction reported on line 29a.

## Schedule L, Form 1120 (Part III, Form 1120-A)

### Balance Sheets per Books

The balance sheet should agree with the corporation's books and records. Include certificates of deposit as cash on line 1, Schedule L.

### Line 5

#### Tax-Exempt Securities

Include on this line:

1. State and local government obligations, the interest on which is excludable from gross income under section 103(a) and
2. Stock in a mutual fund or other RIC that distributed exempt-interest dividends during the tax year of the corporation.

### Line 26, Form 1120 (Line 21, Form 1120-A)

#### Adjustments to Shareholders' Equity

Some examples of adjustments to report on this line include:

- Unrealized gains and losses on securities held "available for sale."
- Foreign currency translation adjustments.
- The excess of additional pension liability over unrecognized prior service cost.
- Guarantees of employee stock (ESOP) debt.
- Compensation related to employee stock award plans.

If the total adjustment to be entered on line 26 (line 21, Form 1120-A) is a negative amount, enter the amount in parentheses.

## Schedule M-1, Form 1120 (Part IV, Form 1120-A)

### Reconciliation of Income (Loss) per Books With Income per Return

#### Line 5c, Form 1120 (Line 5, Form 1120-A)

#### Travel and Entertainment

Include on line 5c (line 5, Form 1120-A) any of the following:

- Meal and entertainment expenses not deductible under section 274(n).
- Expenses for the use of an entertainment facility.
- The part of business gifts over \$25.
- Expenses of an individual over \$2,000, which are allocable to conventions on cruise ships.
- Employee achievement awards over \$400.
- The cost of entertainment tickets over face value (also subject to 50% limit under section 274(n)).
- The cost of skyboxes over the face value of nonluxury box seat tickets.
- The part of luxury water travel expenses not deductible under section 274(m).
- Expenses for travel as a form of education.
- Other nondeductible travel and entertainment expenses.

For more information, see Pub. 542.

### Line 7, Form 1120 (Line 6, Form 1120-A)

#### Tax-Exempt Interest

Include as interest on line 7 (line 6, Form 1120-A), any exempt-interest dividends received as a shareholder in a mutual fund or other RIC.

**Paperwork Reduction Act Notice.** We ask for the information on these forms to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file the following forms will vary depending on individual circumstances. The estimated average times are:

Form	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS
1120	71 hr., 18 min.	43 hr., 29 min.	75 hr., 24 min.	8 hr., 18 min.
1120-A	43 hr., 45 min.	24 hr., 34 min.	49 hr., 3 min.	5 hr., 5 min.
Sch. D (1120)	7 hr., 10 min.	4 hr., 6 min.	6 hr., 16 min.	32 min.
Sch. H (1120)	5 hr., 58 min.	35 min.	43 min.	-----
Sch. N (1120)	3 hr., 35 min.	1 hr., 7 min.	3 hr., 6 min.	32 min.
Sch. PH (1120)	15 hr., 18 min.	6 hr., 12 min.	8 hr., 35 min.	32 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **Do not** send the tax form to this address. Instead, see **Where To File** on page 3.

## Forms 1120 and 1120-A

### Codes for Principal Business Activity

This list of principal business activities and their associated codes is designed to classify an enterprise by the type of activity in which it is engaged to facilitate the administration of the Internal Revenue Code. These principal business activity codes are based on the North American Industry Classification System.

Using the list of activities and codes below, determine from which activity the company derives the largest percentage of its "total receipts." Total receipts is defined as the sum of gross receipts or sales (page 1, line 1a) plus all other income (page 1, lines 4 through 10). If the company purchases raw materials and supplies them to a subcontractor to produce the finished product, but retains title to the product, the company is considered a manufacturer and must use one of the manufacturing codes (311110-339900).

Once the principal business activity is determined, entries must be made on Form 1120, Schedule K, lines 2a, 2b, and 2c, or on Form 1120-A, Part II, lines 1a, 1b, and 1c. For the business activity code number, enter the six digit code selected from the list below. On the next line (Form 1120, line 2b, or Form 1120-A, line 1b), enter a brief description of the company's business activity. Finally, enter a description of the principal product or service of the company on Form 1120, line 2c, or Form 1120-A, line 1c.

#### Agriculture, Forestry, Fishing and Hunting

##### Code

##### Crop Production

111100 Oilseed & Grain Farming  
111210 Vegetable & Melon Farming (including potatoes & yams)  
111300 Fruit & Tree Nut Farming  
111400 Greenhouse, Nursery, & Floriculture Production  
111900 Other Crop Farming (including tobacco, cotton, sugarcane, hay, peanut, sugar beet & all other crop farming)

##### Animal Production

112111 Beef Cattle Ranching & Farming  
112112 Cattle Feedlots  
112120 Dairy Cattle & Milk Production  
112210 Hog & Pig Farming  
112300 Poultry & Egg Production  
112400 Sheep & Goat Farming  
112510 Animal Aquaculture (including shellfish & finfish farms & hatcheries)  
112900 Other Animal Production

##### Forestry and Logging

113110 Timber Tract Operations  
113210 Forest Nurseries & Gathering of Forest Products  
113310 Logging

##### Fishing, Hunting and Trapping

114110 Fishing  
114210 Hunting & Trapping

##### Support Activities for Agriculture and Forestry

115110 Support Activities for Crop Production (including cotton ginning, soil preparation, planting, & cultivating)  
115210 Support Activities for Animal Production  
115310 Support Activities For Forestry

##### Mining

211110 Oil & Gas Extraction  
212110 Coal Mining  
212200 Metal Ore Mining  
212310 Stone Mining & Quarrying  
212320 Sand, Gravel, Clay, & Ceramic & Refractory Minerals Mining & Quarrying  
212390 Other Nonmetallic Mineral Mining & Quarrying  
213110 Support Activities for Mining

##### Utilities

221100 Electric Power Generation, Transmission & Distribution  
221210 Natural Gas Distribution  
221300 Water, Sewage & Other Systems

#### Construction

##### Code

##### Building, Developing, and General Contracting

233110 Land Subdivision & Land Development  
233200 Residential Building Construction  
233300 Nonresidential Building Construction

##### Heavy Construction

234100 Highway, Street, Bridge, & Tunnel Construction  
234900 Other Heavy Construction

##### Special Trade Contractors

235110 Plumbing, Heating, & Air-Conditioning Contractors  
235210 Painting & Wall Covering Contractors  
235310 Electrical Contractors  
235400 Masonry, Drywall, Insulation, & Tile Contractors  
235500 Carpentry & Floor Contractors  
235610 Roofing, Siding, & Sheet Metal Contractors  
235710 Concrete Contractors  
235810 Water Well Drilling Contractors  
235900 Other Special Trade Contractors

#### Manufacturing

##### Food Manufacturing

311110 Animal Food Mfg  
311200 Grain & Oilseed Milling  
311300 Sugar & Confectionery Product Mfg  
311400 Fruit & Vegetable Preserving & Specialty Food Mfg  
311500 Dairy Product Mfg  
311610 Animal Slaughtering and Processing  
311710 Seafood Product Preparation & Packaging  
311800 Bakeries & Tortilla Mfg  
311900 Other Food Mfg (including coffee, tea, flavorings & seasonings)

##### Beverage and Tobacco Product Manufacturing

312110 Soft Drink & Ice Mfg  
312120 Breweries  
312130 Wineries  
312140 Distilleries  
312200 Tobacco Manufacturing

##### Textile Mills and Textile Product Mills

313000 Textile Mills  
314000 Textile Product Mills

##### Apparel Manufacturing

315100 Apparel Knitting Mills  
315210 Cut & Sew Apparel Contractors  
315220 Men's & Boys' Cut & Sew Apparel Mfg

##### Code

315230 Women's & Girls' Cut & Sew Apparel Mfg  
315290 Other Cut & Sew Apparel Mfg  
315990 Apparel Accessories & Other Apparel Mfg

##### Leather and Allied Product Manufacturing

316110 Leather & Hide Tanning & Finishing  
316210 Footwear Mfg (including rubber & plastics)  
316990 Other Leather & Allied Product Mfg

##### Wood Product Manufacturing

321110 Sawmills & Wood Preservation  
321210 Veneer, Plywood, & Engineered Wood Product Mfg  
321900 Other Wood Product Mfg

##### Paper Manufacturing

322100 Pulp, Paper, & Paperboard Mills  
322200 Converted Paper Product Mfg

##### Printing and Related Support Activities

323100 Printing & Related Support Activities

##### Petroleum and Coal Products Manufacturing

324110 Petroleum Refineries (including integrated)  
324120 Asphalt Paving, Roofing, & Saturated Materials Mfg  
324190 Other Petroleum & Coal Products Mfg

##### Chemical Manufacturing

325100 Basic Chemical Mfg  
325200 Resin, Synthetic Rubber, & Artificial & Synthetic Fibers & Filaments Mfg  
325300 Pesticide, Fertilizer, & Other Agricultural Chemical Mfg  
325410 Pharmaceutical & Medicine Mfg  
325500 Paint, Coating, & Adhesive Mfg  
325600 Soap, Cleaning Compound, & Toilet Preparation Mfg  
325900 Other Chemical Product & Preparation Mfg

##### Plastics and Rubber Products Manufacturing

326100 Plastics Product Mfg  
326200 Rubber Product Mfg

##### Nonmetallic Mineral Product Manufacturing

327100 Clay Product & Refractory Mfg  
327210 Glass & Glass Product Mfg  
327300 Cement & Concrete Product Mfg  
327400 Lime & Gypsum Product Mfg  
327900 Other Nonmetallic Mineral Product Mfg

##### Primary Metal Manufacturing

331110 Iron & Steel Mills & Ferroalloy Mfg  
331200 Steel Product Mfg from Purchased Steel  
331310 Alumina & Aluminum Production & Processing  
331400 Nonferrous Metal (except Aluminum) Production & Processing  
331500 Foundries

##### Fabricated Metal Product Manufacturing

332110 Forging & Stamping  
332210 Cutlery & Handtool Mfg  
332300 Architectural & Structural Metals Mfg  
332400 Boiler, Tank, & Shipping Container Mfg  
332510 Hardware Mfg  
332610 Spring & Wire Product Mfg  
332700 Machine Shops; Turned Product; & Screw, Nut, & Bolt Mfg  
332810 Coating, Engraving, Heat Treating, & Allied Activities

##### Code

332900 Other Fabricated Metal Product Mfg

##### Machinery Manufacturing

333100 Agriculture, Construction, & Mining Machinery Mfg  
333200 Industrial Machinery Mfg  
333310 Commercial & Service Industry Machinery Mfg  
333410 Ventilation, Heating, Air-Conditioning, & Commercial Refrigeration Equipment Mfg  
333510 Metalworking Machinery Mfg  
333610 Engine, Turbine & Power Transmission Equipment Mfg  
333900 Other General Purpose Machinery Mfg

##### Computer and Electronic Product Manufacturing

334110 Computer & Peripheral Equipment Mfg  
334200 Communications Equipment Mfg  
334310 Audio & Video Equipment Mfg  
334410 Semiconductor & Other Electronic Component Mfg  
334500 Navigational, Measuring, Electromedical, & Control Instruments Mfg  
334610 Manufacturing & Reproducing Magnetic & Optical Media

##### Electrical Equipment, Appliance, and Component Manufacturing

335100 Electric Lighting Equipment Mfg  
335200 Household Appliance Mfg  
335310 Electrical Equipment Mfg  
335900 Other Electrical Equipment & Component Mfg

##### Transportation Equipment Manufacturing

336100 Motor Vehicle Mfg  
336210 Motor Vehicle Body & Trailer Mfg  
336300 Motor Vehicle Parts Mfg  
336410 Aerospace Product & Parts Mfg  
336510 Railroad Rolling Stock Mfg  
336610 Ship & Boat Building  
336990 Other Transportation Equipment Mfg

##### Furniture and Related Product Manufacturing

337000 Furniture & Related Product Manufacturing

##### Miscellaneous Manufacturing

339110 Medical Equipment & Supplies Mfg  
339900 Other Miscellaneous Manufacturing

#### Wholesale Trade

##### Wholesale Trade, Durable Goods

421100 Motor Vehicle & Motor Vehicle Parts & Supplies Wholesalers  
421200 Furniture & Home Furnishing Wholesalers  
421300 Lumber & Other Construction Materials Wholesalers  
421400 Professional & Commercial Equipment & Supplies Wholesalers  
421500 Metal & Mineral (except Petroleum) Wholesalers  
421600 Electrical Goods Wholesalers  
421700 Hardware, & Plumbing & Heating Equipment & Supplies Wholesalers  
421800 Machinery, Equipment, & Supplies Wholesalers  
421910 Sporting & Recreational Goods & Supplies Wholesalers  
421920 Toy & Hobby Goods & Supplies Wholesalers  
421930 Recyclable Material Wholesalers  
421940 Jewelry, Watch, Precious Stone, & Precious Metal Wholesalers  
421990 Other Miscellaneous Durable Goods Wholesalers

<p><b>Code</b></p> <p><b>Wholesale Trade, Nondurable Goods</b></p> <p>422100 Paper &amp; Paper Product Wholesalers</p> <p>422210 Drugs &amp; Druggists' Sundries Wholesalers</p> <p>422300 Apparel, Piece Goods, &amp; Notions Wholesalers</p> <p>422400 Grocery &amp; Related Product Wholesalers</p> <p>422500 Farm Product Raw Material Wholesalers</p> <p>422600 Chemical &amp; Allied Products Wholesalers</p> <p>422700 Petroleum &amp; Petroleum Products Wholesalers</p> <p>422800 Beer, Wine, &amp; Distilled Alcoholic Beverage Wholesalers</p> <p>422910 Farm Supplies Wholesalers</p> <p>422920 Book, Periodical, &amp; Newspaper Wholesalers</p> <p>422930 Flower, Nursery Stock, &amp; Florists' Supplies Wholesalers</p> <p>422940 Tobacco &amp; Tobacco Product Wholesalers</p> <p>422950 Paint, Varnish, &amp; Supplies Wholesalers</p> <p>422990 Other Miscellaneous Nondurable Goods Wholesalers</p>	<p><b>Code</b></p> <p><b>Clothing and Clothing Accessories Stores</b></p> <p>448110 Men's Clothing Stores</p> <p>448120 Women's Clothing Stores</p> <p>448130 Children's &amp; Infants' Clothing Stores</p> <p>448140 Family Clothing Stores</p> <p>448150 Clothing Accessories Stores</p> <p>448190 Other Clothing Stores</p> <p>448210 Shoe Stores</p> <p>448310 Jewelry Stores</p> <p>448320 Luggage &amp; Leather Goods Stores</p> <p><b>Sporting Goods, Hobby, Book, and Music Stores</b></p> <p>451110 Sporting Goods Stores</p> <p>451120 Hobby, Toy, &amp; Game Stores</p> <p>451130 Sewing, Needlework, &amp; Piece Goods Stores</p> <p>451140 Musical Instrument &amp; Supplies Stores</p> <p>451211 Book Stores</p> <p>451212 News Dealers &amp; Newsstands</p> <p>451220 Prerecorded Tape, Compact Disc, &amp; Record Stores</p> <p><b>General Merchandise Stores</b></p> <p>452110 Department stores</p> <p>452900 Other General Merchandise Stores</p> <p><b>Miscellaneous Store Retailers</b></p> <p>453110 Florists</p> <p>453210 Office Supplies &amp; Stationery Stores</p> <p>453220 Gift, Novelty, &amp; Souvenir Stores</p> <p>453310 Used Merchandise Stores</p> <p>453910 Pet &amp; Pet Supplies Stores</p> <p>453920 Art Dealers</p> <p>453930 Manufactured (Mobile) Home Dealers</p> <p>453990 All Other Miscellaneous Store Retailers (including tobacco, candle, &amp; trophy shops)</p> <p><b>Nonstore Retailers</b></p> <p>454110 Electronic Shopping &amp; Mail-Order Houses</p> <p>454210 Vending Machine Operators</p> <p>454311 Heating Oil Dealers</p> <p>454312 Liquefied Petroleum Gas (Bottled Gas) Dealers</p> <p>454319 Other Fuel Dealers</p> <p>454390 Other Direct Selling Establishments (including door-to-door retailing, frozen food plan providers, party plan merchandisers, &amp; coffee-break service providers)</p>	<p><b>Code</b></p> <p><b>Support Activities for Transportation</b></p> <p>488100 Support Activities for Air Transportation</p> <p>488210 Support Activities for Rail Transportation</p> <p>488300 Support Activities for Water Transportation</p> <p>488410 Motor Vehicle Towing</p> <p>488490 Other Support Activities for Road Transportation</p> <p>488510 Freight Transportation Arrangement</p> <p>488990 Other Support Activities for Transportation</p> <p><b>Couriers and Messengers</b></p> <p>492110 Couriers</p> <p>492210 Local Messengers &amp; Local Delivery</p> <p><b>Warehousing and Storage</b></p> <p>493100 Warehousing &amp; Storage (except lessors of miniwarehouses &amp; self-storage units)</p>	<p><b>Code</b></p> <p>523210 Securities &amp; Commodity Exchanges</p> <p>523900 Other Financial Investment Activities (including portfolio management &amp; investment advice)</p> <p><b>Insurance Carriers and Related Activities</b></p> <p>524140 Direct Life, Health, &amp; Medical Insurance &amp; Reinsurance Carriers</p> <p>524150 Direct Insurance &amp; Reinsurance (except Life, Health &amp; Medical) Carriers</p> <p>524210 Insurance Agencies &amp; Brokerages</p> <p>524290 Other Insurance Related Activities</p> <p><b>Funds, Trusts, and Other Financial Vehicles</b></p> <p>525100 Insurance &amp; Employee Benefit Funds</p> <p>525910 Open-End Investment Funds (Form 1120-RIC)</p> <p>525920 Trusts, Estates, &amp; Agency Accounts</p> <p>525930 Real Estate Investment Trusts (Form 1120-REIT)</p> <p>525990 Other Financial Vehicles</p> <p>"Offices of Bank Holding Companies" and "Offices of Other Holding Companies," are located under <b>Management of Companies (Holding Companies)</b> on page 23.</p>
<p><b>Retail Trade</b></p> <p><b>Motor Vehicle and Parts Dealers</b></p> <p>441110 New Car Dealers</p> <p>441120 Used Car Dealers</p> <p>441210 Recreational Vehicle Dealers</p> <p>441221 Motorcycle Dealers</p> <p>441222 Boat Dealers</p> <p>441229 All Other Motor Vehicle Dealers</p> <p>441300 Automotive Parts, Accessories, &amp; Tire Stores</p> <p><b>Furniture and Home Furnishings Stores</b></p> <p>442110 Furniture Stores</p> <p>442210 Floor Covering Stores</p> <p>442291 Window Treatment Stores</p> <p>442299 All Other Home Furnishings Stores</p> <p><b>Electronics and Appliance Stores</b></p> <p>443111 Household Appliance Stores</p> <p>443112 Radio, Television, &amp; Other Electronics Stores</p> <p>443120 Computer &amp; Software Stores</p> <p>443130 Camera &amp; Photographic Supplies Stores</p> <p><b>Building Material and Garden Equipment and Supplies Dealers</b></p> <p>444110 Home Centers</p> <p>444120 Paint &amp; Wallpaper Stores</p> <p>444130 Hardware Stores</p> <p>444190 Other Building Material Dealers</p> <p>444200 Lawn &amp; Garden Equipment &amp; Supplies Stores</p>	<p><b>Transportation and Warehousing</b></p> <p><b>Air, Rail, and Water Transportation</b></p> <p>481000 Air Transportation</p> <p>482110 Rail Transportation</p> <p>483000 Water Transportation</p> <p><b>Truck Transportation</b></p> <p>484110 General Freight Trucking, Local</p> <p>484120 General Freight Trucking, Long-distance</p> <p>484200 Specialized Freight Trucking</p> <p><b>Transit and Ground Passenger Transportation</b></p> <p>485110 Urban Transit Systems</p> <p>485210 Interurban &amp; Rural Bus Transportation</p> <p>485310 Taxi Service</p> <p>485320 Limousine Service</p> <p>485410 School &amp; Employee Bus Transportation</p> <p>485510 Charter Bus Industry</p> <p>485990 Other Transit &amp; Ground Passenger Transportation</p> <p><b>Pipeline Transportation</b></p> <p>486000 Pipeline Transportation</p> <p><b>Scenic &amp; Sightseeing Transportation</b></p> <p>487000 Scenic &amp; Sightseeing Transportation</p>	<p><b>Information</b></p> <p><b>Publishing Industries</b></p> <p>511110 Newspaper Publishers</p> <p>511120 Periodical Publishers</p> <p>511130 Book Publishers</p> <p>511140 Database &amp; Directory Publishers</p> <p>511190 Other Publishers</p> <p>511210 Software Publishers</p> <p><b>Motion Picture and Sound Recording Industries</b></p> <p>512100 Motion Picture &amp; Video Industries (except video rental)</p> <p>512200 Sound Recording Industries</p> <p><b>Broadcasting and Telecommunications</b></p> <p>513100 Radio &amp; Television Broadcasting</p> <p>513200 Cable Networks &amp; Program Distribution</p> <p>513300 Telecommunications (including paging, cellular, satellite, &amp; other telecommunications)</p> <p><b>Information Services and Data Processing Services</b></p> <p>514100 Information Services (including news syndicates, libraries, &amp; on-line information services)</p> <p>514210 Data Processing Services</p> <p><b>Finance and Insurance</b></p> <p><b>Depository Credit Intermediation</b></p> <p>522110 Commercial Banking</p> <p>522120 Savings Institutions</p> <p>522130 Credit Unions</p> <p>522190 Other Depository Credit Intermediation</p> <p><b>Nondepository Credit Intermediation</b></p> <p>522210 Credit Card Issuing</p> <p>522220 Sales Financing</p> <p>522291 Consumer Lending</p> <p>522292 Real Estate Credit (including mortgage bankers &amp; originators)</p> <p>522293 International Trade Financing</p> <p>522294 Secondary Market Financing</p> <p>522298 All Other Nondepository Credit Intermediation</p> <p><b>Activities Related to Credit Intermediation</b></p> <p>522300 Activities Related to Credit Intermediation (including loan brokers)</p> <p><b>Securities, Commodity Contracts, and Other Financial Investments and Related Activities</b></p> <p>523110 Investment Banking &amp; Securities Dealing</p> <p>523120 Securities Brokerage</p> <p>523130 Commodity Contracts Dealing</p> <p>523140 Commodity Contracts Brokerage</p>	<p><b>Real Estate and Rental and Leasing</b></p> <p><b>Real Estate</b></p> <p>531110 Lessors of Residential Buildings &amp; Dwellings</p> <p>531114 Cooperative Housing</p> <p>531120 Lessors of Nonresidential Buildings (except Miniwarehouses)</p> <p>531130 Lessors of Miniwarehouses &amp; Self-Storage Units</p> <p>531190 Lessors of Other Real Estate Property</p> <p>531210 Offices of Real Estate Agents &amp; Brokers</p> <p>531310 Real Estate Property Managers</p> <p>531320 Offices of Real Estate Appraisers</p> <p>531390 Other Activities Related to Real Estate</p> <p><b>Rental and Leasing Services</b></p> <p>532100 Automotive Equipment Rental &amp; Leasing</p> <p>532210 Consumer Electronics &amp; Appliances Rental</p> <p>532220 Formal Wear &amp; Costume Rental</p> <p>532230 Video Tape &amp; Disc Rental</p> <p>532290 Other Consumer Goods Rental</p> <p>532310 General Rental Centers</p> <p>532400 Commercial &amp; Industrial Machinery &amp; Equipment Rental &amp; Leasing</p> <p><b>Lessors of Nonfinancial Intangible Assets (except copyrighted works)</b></p> <p>533110 Lessors of Nonfinancial Intangible Assets (except copyrighted works)</p>
<p><b>Food and Beverage Stores</b></p> <p>445110 Supermarkets and Other Grocery (except Convenience) Stores</p> <p>445120 Convenience Stores</p> <p>445210 Meat Markets</p> <p>445220 Fish &amp; Seafood Markets</p> <p>445230 Fruit &amp; Vegetable Markets</p> <p>445291 Baked Goods Stores</p> <p>445292 Confectionery &amp; Nut Stores</p> <p>445299 All Other Specialty Food Stores</p> <p>445310 Beer, Wine, &amp; Liquor Stores</p> <p><b>Health and Personal Care Stores</b></p> <p>446110 Pharmacies &amp; Drug Stores</p> <p>446120 Cosmetics, Beauty Supplies, &amp; Perfume Stores</p> <p>446130 Optical Goods Stores</p> <p>446190 Other Health &amp; Personal Care Stores</p> <p><b>Gasoline Stations</b></p> <p>447100 Gasoline Stations (including convenience stores with gas)</p>	<p><b>Professional, Scientific, and Technical Services</b></p> <p><b>Legal Services</b></p> <p>541110 Offices of Lawyers</p> <p>541190 Other Legal Services</p> <p><b>Accounting, Tax Preparation, Bookkeeping, and Payroll Services</b></p> <p>541211 Offices of Certified Public Accountants</p> <p>541213 Tax Preparation Services</p> <p>541214 Payroll Services</p> <p>541219 Other Accounting Services</p> <p><b>Architectural, Engineering, and Related Services</b></p> <p>541310 Architectural Services</p>	<p><b>Management of Companies (Holding Companies)</b> on page 23.</p>	<p><b>Professional, Scientific, and Technical Services</b></p> <p><b>Legal Services</b></p> <p>541110 Offices of Lawyers</p> <p>541190 Other Legal Services</p> <p><b>Accounting, Tax Preparation, Bookkeeping, and Payroll Services</b></p> <p>541211 Offices of Certified Public Accountants</p> <p>541213 Tax Preparation Services</p> <p>541214 Payroll Services</p> <p>541219 Other Accounting Services</p> <p><b>Architectural, Engineering, and Related Services</b></p> <p>541310 Architectural Services</p>

<p><b>Code</b></p> <p>541320 Landscape Architecture Services</p> <p>541330 Engineering Services</p> <p>541340 Drafting Services</p> <p>541350 Building Inspection Services</p> <p>541360 Geophysical Surveying &amp; Mapping Services</p> <p>541370 Surveying &amp; Mapping (except Geophysical) Services</p> <p>541380 Testing Laboratories</p> <p><b>Specialized Design Services</b></p> <p>541400 Specialized Design Services (including interior, industrial, graphic, &amp; fashion design)</p> <p><b>Computer Systems Design and Related Services</b></p> <p>541511 Custom Computer Programming Services</p> <p>541512 Computer Systems Design Services</p> <p>541513 Computer Facilities Management Services</p> <p>541519 Other Computer Related Services</p> <p><b>Other Professional, Scientific, and Technical Services</b></p> <p>541600 Management, Scientific, &amp; Technical Consulting Services</p> <p>541700 Scientific Research &amp; Development Services</p> <p>541800 Advertising &amp; Related Services</p> <p>541910 Marketing Research &amp; Public Opinion Polling</p> <p>541920 Photographic Services</p> <p>541930 Translation &amp; Interpretation Services</p> <p>541940 Veterinary Services</p> <p>541990 All Other Professional, Scientific, &amp; Technical Services</p>	<p><b>Code</b></p> <p>561500 Travel Arrangement &amp; Reservation Services</p> <p>561600 Investigation &amp; Security Services</p> <p>561710 Exterminating &amp; Pest Control Services</p> <p>561720 Janitorial Services</p> <p>561730 Landscaping Services</p> <p>561740 Carpet &amp; Upholstery Cleaning Services</p> <p>561790 Other Services to Buildings &amp; Dwellings</p> <p>561900 Other Support Services (including packaging &amp; labeling services, &amp; convention &amp; trade show organizers)</p> <p><b>Waste Management and Remediation Services</b></p> <p>562000 Waste Management &amp; Remediation Services</p>	<p><b>Code</b></p> <p><b>Other Ambulatory Health Care Services</b></p> <p>621900 Other Ambulatory Health Care Services (including ambulance services &amp; blood &amp; organ banks)</p> <p><b>Hospitals</b></p> <p>622000 Hospitals</p> <p><b>Nursing and Residential Care Facilities</b></p> <p>623000 Nursing &amp; Residential Care Facilities</p> <p><b>Social Assistance</b></p> <p>624100 Individual &amp; Family Services</p> <p>624200 Community Food &amp; Housing, &amp; Emergency &amp; Other Relief Services</p> <p>624310 Vocational Rehabilitation Services</p> <p>624410 Child Day Care Services</p>	<p><b>Code</b></p> <p><b>Food Services and Drinking Places</b></p> <p>722110 Full-Service Restaurants</p> <p>722210 Limited-Service Eating Places</p> <p>722300 Special Food Services (including food service contractors &amp; caterers)</p> <p>722410 Drinking Places (Alcoholic Beverages)</p>
<p><b>Management of Companies (Holding Companies)</b></p> <p>551111 Offices of Bank Holding Companies</p> <p>551112 Offices of Other Holding Companies</p>	<p><b>Educational Services</b></p> <p>611000 Educational Services (including schools, colleges, &amp; universities)</p>	<p><b>Arts, Entertainment, and Recreation</b></p> <p><b>Performing Arts, Spectator Sports, and Related Industries</b></p> <p>711100 Performing Arts Companies</p> <p>711210 Spectator Sports (including sports clubs &amp; racetracks)</p> <p>711300 Promoters of Performing Arts, Sports, &amp; Similar Events</p> <p>711410 Agents &amp; Managers for Artists, Athletes, Entertainers, &amp; Other Public Figures</p> <p>711510 Independent Artists, Writers, &amp; Performers</p> <p><b>Museums, Historical Sites, and Similar Institutions</b></p> <p>712100 Museums, Historical Sites, &amp; Similar Institutions</p> <p><b>Amusement, Gambling, and Recreation Industries</b></p> <p>713100 Amusement Parks &amp; Arcades</p> <p>713200 Gambling Industries</p> <p>713900 Other Amusement &amp; Recreation Industries (including golf courses, skiing facilities, marinas, fitness centers, &amp; bowling centers)</p>	<p><b>Other Services</b></p> <p><b>Repair and Maintenance</b></p> <p>811110 Automotive Mechanical &amp; Electrical Repair &amp; Maintenance</p> <p>811120 Automotive Body, Paint, Interior, &amp; Glass Repair</p> <p>811190 Other Automotive Repair &amp; Maintenance (including oil change &amp; lubrication shops &amp; car washes)</p> <p>811210 Electronic &amp; Precision Equipment Repair &amp; Maintenance</p> <p>811310 Commercial &amp; Industrial Machinery &amp; Equipment (except Automotive &amp; Electronic) Repair &amp; Maintenance</p> <p>811410 Home &amp; Garden Equipment &amp; Appliance Repair &amp; Maintenance</p> <p>811420 Reupholstery &amp; Furniture Repair</p> <p>811430 Footwear &amp; Leather Goods Repair</p> <p>811490 Other Personal &amp; Household Goods Repair &amp; Maintenance</p> <p><b>Personal and Laundry Services</b></p> <p>812111 Barber Shops</p> <p>812112 Beauty Salons</p> <p>812113 Nail Salons</p> <p>812190 Other Personal Care Services (including diet &amp; weight reducing centers)</p> <p>812210 Funeral Homes &amp; Funeral Services</p> <p>812220 Cemeteries &amp; Crematories</p> <p>812310 Coin-Operated Laundries &amp; Drycleaners</p> <p>812320 Drycleaning &amp; Laundry Services (except Coin-Operated)</p> <p>812330 Linen &amp; Uniform Supply</p> <p>812910 Pet Care (except Veterinary) Services</p> <p>812920 Photofinishing</p> <p>812930 Parking Lots &amp; Garages</p> <p>812990 All Other Personal Services</p> <p><b>Religious, Grantmaking, Civic, Professional, and Similar Organizations</b></p> <p>813000 Religious, Grantmaking, Civic, Professional, &amp; Similar Organizations (including condominium and homeowners associations)</p>
<p><b>Administrative and Support and Waste Management and Remediation Services</b></p> <p><b>Administrative and Support Services</b></p> <p>561110 Office Administrative Services</p> <p>561210 Facilities Support Services</p> <p>561300 Employment Services</p> <p>561410 Document Preparation Services</p> <p>561420 Telephone Call Centers</p> <p>561430 Business Service Centers (including private mail centers &amp; copy shops)</p> <p>561440 Collection Agencies</p> <p>561450 Credit Bureaus</p> <p>561490 Other Business Support Services (including repossession services, court reporting, &amp; stenotype services)</p>	<p><b>Health Care and Social Assistance</b></p> <p><b>Offices of Physicians and Dentists</b></p> <p>621111 Offices of Physicians (except mental health specialists)</p> <p>621112 Offices of Physicians, Mental Health Specialists</p> <p>621210 Offices of Dentists</p> <p><b>Offices of Other Health Practitioners</b></p> <p>621310 Offices of Chiropractors</p> <p>621320 Offices of Optometrists</p> <p>621330 Offices of Mental Health Practitioners (except Physicians)</p> <p>621340 Offices of Physical, Occupational &amp; Speech Therapists, &amp; Audiologists</p> <p>621391 Offices of Podiatrists</p> <p>621399 Offices of All Other Miscellaneous Health Practitioners</p> <p><b>Outpatient Care Centers</b></p> <p>621410 Family Planning Centers</p> <p>621420 Outpatient Mental Health &amp; Substance Abuse Centers</p> <p>621491 HMO Medical Centers</p> <p>621492 Kidney Dialysis Centers</p> <p>621493 Freestanding Ambulatory Surgical &amp; Emergency Centers</p> <p>621498 All Other Outpatient Care Centers</p> <p><b>Medical and Diagnostic Laboratories</b></p> <p>621510 Medical &amp; Diagnostic Laboratories</p> <p><b>Home Health Care Services</b></p> <p>621610 Home Health Care Services</p>	<p><b>Accommodation and Food Services</b></p> <p><b>Accommodation</b></p> <p>721110 Hotels (except casino hotels) &amp; Motels</p> <p>721120 Casino Hotels</p> <p>721191 Bed &amp; Breakfast Inns</p> <p>721199 All Other Traveler Accommodation</p> <p>721210 RV (Recreational Vehicle) Parks &amp; Recreational Camps</p> <p>721310 Rooming &amp; Boarding Houses</p>	

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**Index**

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<b>A</b>		<b>E</b>		<b>L</b>		<b>R</b>	
Accounting methods . . . . .	5	Electronic Federal Tax Payment System (EFTPS) . .	6	LIFO recapture amount: Tax on . . . . .	19	Recapture taxes . . . . .	18
Accounting periods . . . . .	6	Employee benefit programs . .	12	LIFO recapture: Where to report . . . . .	9	Reconciliation of income . . . .	20
Address change . . . . .	8	Employer identification number (EIN) . . . . .	7	Limitations on deductions . . . .	9	Recordkeeping . . . . .	6
Affiliated group . . . . .	19	Estimated tax: Overpaid . . . . .	6	Lobbying expenses, nondeductibility . . . . .	12	Related party transactions . . . .	9
Amended return . . . . .	5	Payments . . . . .	6, 13			Rents (expense) . . . . .	10
Apportionment plan . . . . .	17	Penalty . . . . .	14			Rents (income) . . . . .	8
Assembling the return . . . . .	5	Extension of time to file . . . . .	2			Repairs and maintenance . . . .	10
At-risk rules . . . . .	12	Extraterritorial income . . . . .	8				
<b>B</b>				<b>M</b>		<b>S</b>	
Backup withholding . . . . .	14			Mark-to-market accounting method . . . . .	5	Salaries and wages . . . . .	10
Bad debts . . . . .	10			Minimum tax: Alternative . . . . .	18	Schedule: A . . . . .	14
Balance sheets . . . . .	20	<b>F</b>		Prior year, credit for . . . . .	18	C . . . . .	15
Business startup expenses . . . .	9	Farming, corporations engaged in . . . . .	2	Mutual savings banks conducting life insurance business . . . . .	17	J . . . . .	16
<b>C</b>		Final return . . . . .	8			K . . . . .	19
Capital construction fund: Deduction for contributions . . . . .	13	Financial asset securitization investment trust (FASIT) . . . .	2			L . . . . .	20
Tax on nonqualified withdrawal . . . . .	19	Foreign corporation, stock ownership in . . . . .	5			M-1 . . . . .	20
Capital gain net income . . . . .	8	Foreign financial accounts . . . .	19	<b>N</b>		Section 263A costs . . . . .	9, 14
Closely held corporations . . . . .	9	Foreign person (defined) . . . .	19	Name change . . . . .	8	Shareholders' equity adjustments . . . . .	20
Compensation of officers . . . . .	9	Foreign tax credit . . . . .	18	Net operating loss . . . . .	13, 20	Signature . . . . .	3
Consolidated return . . . . .	5, 7, 20	Form 1120-A requirements . . . .	2	Nonaccrual experience method . . . . .	8	Special returns for certain organizations . . . . .	2
Contributions to reduce the public debt . . . . .	1	Forms and publications, how to get . . . . .	1				
Contributions, charitable . . . . .	10	Fuels, credit for tax on . . . . .	14	<b>O</b>		<b>T</b>	
Controlled group: Member of . . . . .	16			Other deductions . . . . .	12	Tax computation . . . . .	16
Parent-subsidiary . . . . .	19	<b>G</b>		Other income . . . . .	8	Tax issues, unresolved . . . . .	1
Corporate tax shelters . . . . .	5	General business credit . . . . .	18	Other taxes . . . . .	18	Tax rate schedule . . . . .	17
Cost of goods sold . . . . .	8, 14	Golden parachute payments . . . .	9	Ozone-depleting chemicals, credit for tax on . . . . .	14	Tax shelters . . . . .	5
Credits against tax . . . . .	18	Gross receipts . . . . .	8			Tax-exempt securities . . . . .	20
<b>D</b>				<b>P</b>		Taxes and licenses . . . . .	10
Deductions . . . . .	9	<b>I</b>		Partnership income (loss) . . . .	8, 12	Travel, meals, and entertainment . . . . .	12
Depletion . . . . .	11	Income . . . . .	8	Passive activity limitations . . . . .	9		
Depository method of tax payment . . . . .	6	Installment sales . . . . .	8	Penalties . . . . .	7, 14	<b>W</b>	
Depreciation . . . . .	11	Interest due: Late payment of tax . . . . .	7	Pension, profit-sharing, etc. plans . . . . .	12	When to file . . . . .	2
Direct deposit of refund . . . . .	14	Look-back method . . . . .	18	Personal holding company . . . .	7	Where to file . . . . .	3
Disclosure statement . . . . .	5	Interest expense . . . . .	10	Personal holding company tax . . . . .	18	Who must file . . . . .	2
Dividend income . . . . .	8	Interest expense (relating to section 263A) . . . . .	9	Personal service corporation . . . .	7	Who must sign . . . . .	3
Dividends-received deduction . . . . .	15-16	Interest income: Tax-exempt . . . . .	20	Possessions tax credit . . . . .	18	Worksheets: Controlled group members, tax computation . . . . .	17
Dues, membership and other . . . . .	12	Taxable . . . . .	8	Preparer, tax return . . . . .	3	Cost of goods sold . . . . .	14
		Inventory: Section 263A uniform capitalization rules . . . . .	9, 15	Private delivery services . . . . .	2	Schedule C . . . . .	15
		Valuation methods . . . . .	15				
				<b>Q</b>			
				Qualified personal service corporation . . . . .	17		